

TRANSCRIPT

FEDERAL OPEN MARKET COMMITTEE MEETING

August 14, 1979

Prefatory Note

This transcript has been produced from the original raw transcript in the FOMC Secretariat's files. The Secretariat has lightly edited the original to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcript was not fully edited for accuracy at the time it was produced because it was intended only as an aid to the Secretariat in preparing the record of the Committee's policy actions. The edited transcript has not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Staff Statements Appended to the Transcript

Mr. Pardee, Manager for Foreign Operations
Mr. Sternlight, Manager for Domestic Operations
Mr. Zeisel, Associate Economist
Mr. Axilrod, Economist

Meeting of Federal Open Market Committee

August 14, 1979

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., on Tuesday, August 14, 1979, beginning at 9:30 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Balles
Mr. Black
Mr. Coldwell
Mr. Kimbrel
Mr. Mayo
Mr. Partee
Mr. Rice
Mr. Schultz
Mrs. Teeters
Mr. Wallich

Messrs. Guffey, Morris, Roos, Timlen, and Winn,
Alternate Members of the Federal Open Market
Committee

Messrs. Baughman, Eastburn, and Willes, Presidents
of the Federal Reserve Banks of Dallas,
Philadelphia, and Minneapolis, respectively

Mr. Altmann, Secretary
Mr. Bernard 1/, Assistant Secretary
Mr. Oltman 1/, Deputy General Counsel
Mr. Mannion 1/, Assistant General Counsel
Mr. Axilrod 1/, Economist
Mr. Holmes 1/, Adviser for Market Operations

Messrs. Brandt 1/, R. Davis 1/, Keir 1/,
Scheld 1/, Truman 1/, and Zeisel 1/,
Associate Economists

1/ Entered the meeting prior to the vote to approve the Minutes
of Actions.

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Mr. Sternlight 1/, Manager for Domestic Operations, System Open Market Account

Mr. Pardee 1/, Manager for Foreign Operations, System Open Market Account

Mr. Coyne 1/, Assistant to the Board of Governors

Messrs. Farnsworth 1/2/ and Siegman 1/, Associate Directors, Division of Federal Reserve Bank Examinations and Budgets and Division of International Finance, respectively, Board of Governors

Mr. Prell 1/, Associate Research Division Officer, Division of Research and Statistics, Board of Governors

Mr. Robinson 1/2/, Manager, Financial Examinations, Division of Federal Reserve Bank Examinations and Budgets, Board of Governors

Ms. Farar 1/, Economist, Open Market Secretariat, Board of Governors

Mrs. Deck 1/, Staff Assistant, Open Market Secretariat, Board of Governors

Mr. Smoot 1/, First Vice President, Federal Reserve Bank of Philadelphia

Messrs. Burns 1/ and J. Davis 1/, Senior Vice Presidents, Federal Reserve Banks of Dallas and Cleveland, respectively

Messrs. Broadus 1/, Danforth 1/, T. Davis 1/, and Fieleke 1/, Vice Presidents, Federal Reserve Banks of Richmond, Minneapolis, Kansas City, and Boston, respectively

Mr. Burger 1/, Assistant Vice President, Federal Reserve Bank of St. Louis

Mr. Levin 1/, Manager, Securities Department, Federal Reserve Bank of New York

1/ Entered the meeting prior to the vote to approve the Minutes of Actions.

2/ Left the meeting following the vote to accept the Report of Examinations of System Open Market Account.

Transcript of Federal Open Market Committee Meeting of
August 14, 1979

CHAIRMAN VOLCKER. I might say for the benefit of those who have just come in that we had a little executive session to do some important business, the first item of which was to elect a Chairman. I'm not sure whether it's entirely appropriate that I announce my election, but it proceeded.

I should also say that this is the first time the new Vice Chairman of the Board has been privileged to attend an Open Market Committee meeting. We hope it's a privilege, anyway! You can make that judgment some time later, Fred, but I know I am delighted to have you here. Fred has made the point to me several times that as a Princeton graduate he's well qualified. I know from personal experience that that doesn't carry you very far, Fred! You're going to have to stand on other grounds, but you have many other grounds upon which to stand--business experience, entrepreneurial experience, banking experience, and some political experience. We like to consider ourselves apolitical in one sense, but I have found that in another sense a little political talent and understanding never hurts in these positions. So from all sides we are delighted to have you join us. I look forward to working with you and I'm sure the others do as well.

[In our executive session] we did make some other personnel changes which I ask everybody in this room to hold in confidence until they can be completed. After I don't know how many years of valiant service--13 or 14 years I guess--in one of the most harassing jobs that I can conceive of, Alan Holmes [will have a new role.] He served first as Manager of Open Market Operations on the domestic side and then took over on both [the domestic and foreign] sides during some turbulent years, leading the System into a more active posture on the foreign exchange side and seeing that accomplished. We thought the time had appropriately come to take advantage of Mr. Holmes' services as an Adviser so he's still on board. We're still going to benefit from his services for many years to come, I hope, both in the Federal Reserve Bank of New York and in connection with the Open Market Committee--but without direct line responsibility.

The other part of that process is that we have two gentlemen in Peter Sternlight and Scott Pardee ready to take over the full line of responsibilities on the domestic and foreign sides. So the Committee has acted to make Peter the Manager on the domestic side, Scott the Manager on the foreign side, and Alan Holmes Adviser for Market Operations, looking over the shoulders on all sides in a constructive way. I think it can be a very effective team in a slightly different alignment, and I'll be delighted to get this in place. But it is all subject, as I'm sure you know, to concurrent action by the board of directors of the New York Bank by whom these esteemed gentlemen are appointed to their official positions. And the directors don't meet until this Thursday so these changes cannot be put in place until Thursday. I hope they can be put in place then. I'm sure Mr. Timlen can manage that assignment but there won't be any public announcement until the directors act, so I hope you will respect that. And I do welcome all three of you to new assignments.

With that I think we can proceed to the minutes [of the July meeting]. Do we have a motion? Without objection the minutes are approved.

We have a Report of Examination, which I believe has been distributed to you. I am informed that Mr. Farnsworth is ready to answer any questions you may have. Are there any questions about the examination? Mr. Wallich.

MR. WALLICH. Is it possible to figure out the unrealized gain or loss on the account, and have you tried to do so?

MR. FARNSWORTH. Governor Wallich, I have with me today Dave Robinson who is the Manager of the audit team, and I'll turn the question over to him.

CHAIRMAN VOLCKER. Which account are you talking about, the domestic or the foreign?

MR. WALLICH. Domestic. On the foreign side I take it that the rule of [FASB 88] requires us to revalue these assets continuously but I don't believe there is a similar rule for the domestic assets.

MR. ROBINSON. Governor, I don't believe we made any attempt to do that. In our efforts we only made an attempt to verify the balances as they were reflected on the records of the Bank.

MR. WALLICH. Do you see the possibility of doing that? Are there technical difficulties?

MR. PARTEE. Why would you want to do it?

MR. WALLICH. Well, I'd like to know--

MR. PARTEE. Whether it's below water? But we're not going to liquidate the account.

MR. WALLICH. --where we stand. For one thing it would be helpful if we find that we're taking a loss on foreign exchange transactions to remember that the loss may be offset [by gains on the domestic side].

MR. PARTEE. That's the reason.

MR. MAYO. What's the average length of the System portfolio at this time? Do you have that, Peter--or someone?

MR. STERNLIGHT. It's in the area of 4 to 6 years--something like that.

MR. PARTEE. Oh, really that long?

MR. MAYO. I had no idea it was that long. That adds a little maybe to the reason for Henry's question.

MR. PARTEE. It's probably completely under water then!

MR. MAYO. I would have thought it was more like 2 years.

MR. BLACK. It shatters his hopes of having an offset, though.

MR. COLDWELL. Well, my impression of this examination, Mr. Chairman, was that the books balance and that all the tests they've made indicate that the books are being kept in adequate fashion.

MR. FARNSWORTH. That is correct. We also did a sample of the transactions of the Federal Open Market Trading Desk and ascertained whether the directive was being carried out. All those cases in the random sample indicated that it was.

MR. COLDWELL. It was a random sample, I trust?

MR. FARNSWORTH. A random sample, yes.

MR. COLDWELL. I have no problems with this. I move we approve it.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection, so ordered. Foreign currency operations. Mr. Pardee.

MR. PARDEE. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Any questions or comments?

MR. WALLICH. Scott, do you think the market would respond favorably if there were to be a package that included new Carter bonds? Is that a valuable feature to them?

MR. PARDEE. To some people in the market it would be helpful, yes. Others would not pay too much attention to it, particularly since it's something that had been announced before as part of the November 1st package. But a package usually has something for everybody and there are some who would think that the Carter bonds would be important.

MR. WALLICH. Do you think they'd respond one way or another to forward operations?

MR. PARDEE. It depends on what's coming along with it. The forward market operations right now alone, without any other change, would be seen as a tactical exercise. It's in some ways weaker than spot operations and may be seen as a fallback position on the part of the authorities. Forward operations combined with other activity could add, but I personally would prefer to continue doing spot operations.

MR. COLDWELL. Scott, what is your reaction to this discussion that seems to be going on in a number of quarters about a competitive interest rate "war" between various countries in the world, including the United States?

MR. PARDEE. Well, I don't know; war is a very strong term. But clearly, as I indicated in my [remarks]--and we've felt this for

several months--the response of the central banks and the authorities in Europe is that with higher rates of inflation coming about from the oil price increase and from stronger domestic economies, they have raised their interest rates. The ones within the EMS have a particular problem in that it's harder now for the governments to come to an agreement on changing their exchange rates within the European monetary system; they have to get the agreement of the agricultural ministers as well as the finance ministers. And so particularly the Germans have raised their interest rates over the course of the year in response to these inflationary pressures and expansion of bank credit demand. Others have found they've had to raise their rates to defend their currencies in the exchange market and to fend off their own inflationary pressures--some a bit against their will, I think. And from the United Kingdom side we had a decision on the part of the new Administration there, the Thatcher government, to raise interest rates by a full 2 percentage points back in May, which has set a new course for sterling. And that has occurred. I wouldn't call it a war but other countries have been raising interest rates. There have been several rounds of interest rate hikes, and it's a different atmosphere than we've had in earlier years.

CHAIRMAN VOLCKER. I don't think there's much substance to that now, Phil, but I think it's a useful question to ask oneself about what might happen later in the year. When I look at all these interest rate changes abroad, there's a pretty straightforward justification in terms of their own domestic situations--with rising inflation and strong economies. One begins to ask what happens to their economies later this year or into 1980, partly because of the oil price increases. I think there is some danger but I don't think we can really be critical of what's happened so far.

MR. COLDWELL. Well, I wasn't implying criticism. I was just questioning the market reaction to this type of--

MR. PARDEE. There is a feeling that there is a war going on. I think it's overstated.

MR. PARTEE. The British [action] is a change in policy, and to some degree it looks like the Canadians might be included in that.

CHAIRMAN VOLCKER. The British is a change in policy but it's often stimulated by the exchange rate. In fact, they don't like the exchange rate consequences, as near as I can read it. Larry Roos.

MR. ROOS. Scott, in your report you alluded to some apprehension or nervousness in the market in relation to this meeting today. Is that nervousness that we may tighten monetary policy or that we may continue to vacillate? What did you mean by that?

MR. PARDEE. If you talk to different people, they would give you a different [answer regarding the] nature of the apprehension. I gave you a list of the things that people are bearish about with respect to the rest of [our country's] economic policy and there's still some hope that the Federal Reserve is here and doing its job. [As for] what job that is, you talk to different people and you get different reactions.

MR. ROOS. But the bearishness is essentially a concern about expanding inflation? Is that what you mean?

MR. PARDEE. No, no. These guys are making bets--and that's what they're doing--on whether interest rates are going to be higher after the meeting or not. And how much higher is part of the bet.

MR. ROOS. Doesn't their major concern pertain to their inflationary expectations for the United States? If we came to grips or appeared to come to grips with inflation along the lines of the new Chairman's statements, wouldn't that have a constructive effect on the value of the dollar?

MR. PARDEE. Certainly, if there was a feeling that the actions of the Committee would lead to a reduction in inflation. But again, I'm very cautious about what people are doing on the Friday and Monday before an FOMC meeting. They're just aligning themselves to be in a particular position to anticipate some action which if it comes, they will make money and if it doesn't come, then they won't. But I would not want to overinterpret what these day-to-day swings [mean].

CHAIRMAN VOLCKER. John Balles.

MR. BALLES. I'll approach it from a different way and make it a little more specific. Would you care to speculate, Scott, on what good it might do vis-a-vis market expectations and psychology if we were to snug up a bit more on both the discount rate and the federal funds rate--in a range of 1/4 point to possibly 1/2 point?

MR. PARDEE. Well, it would help with those who are interested in responding to that sort of thing. But as I say, there's a deeper root of concern about the dollar. As long as the Federal Reserve is doing what people think the Federal Reserve should do--and again these are people in financial markets and they are more inclined to look to interest rates as a guiding light--then they will be a little more relaxed. But they're also worried about the question of leadership and economic policy more broadly. So we might buy ourselves some more time--which is what we bought [with] our intervention in late July and the interest rate hike that took place then. That bought us some time. But part of our problem last Friday was that people were calling in and saying all right we know what you've done and we know what the Federal Reserve is trying to do--you have a new Chairman and all that--but another bad price figure just came out. How long are these price figures going to continue? So long as the United States continues to have a higher rate of inflation than Germany, Switzerland, and some of these other countries, it will help [if our rates go up]; it will buy time. But it won't solve the basic problem of confidence in the dollar, which has been troubling us throughout this past year or so.

MR. COLDWELL. Scott, has the market changed its attitude at all about intervention?

MR. PARDEE. Well, I don't know which attitude you mean. Again, they expect us to be there. If we aren't, then everybody will be very disappointed and we'd have a real problem on our hands. So we have to show up when the problems do emerge.

MR. COLDWELL. My impression though is that they're not willing to challenge us--

MR. PARDEE. Oh, yes they are.

MR. COLDWELL. --on the total of intervention. In other words, they're not willing to push us into saying okay we'll put \$10 billion into this package.

MR. PARDEE. Well, that's part of the package idea. There are those who are touting a package, who call in and say you guys need a package and one of the elements is the fact that \$30 billion won't do it. As for the November 1st package, for all we know you've spent it all already. It's that sort of thing. So then you get in the idea that Henry raised of Carter bonds and hikes in interest rates; the list is just as long as one's arm depending, again, on which person you're talking to. And they're still prepared a little to challenge us in the market but not quite so much. What we did in late July really stopped a number of the players. And our operation last Friday quieted a few others. But it's temporary; they'll be back.

MR. BLACK. Most of what I wanted to ask, Mr. Chairman, has been asked. But, Scott, in retrospect do you think we would have been significantly better off so far as the dollar is concerned if we had moved the discount rate one point instead of a half point?

MR. PARDEE. I don't know. I'm trying to interpret a wide range of things without trying to interpose my own views, so I'm not sure. In view of what was going on at that time, I think what was given was a signal of concern by the Federal Reserve, and that's what the market wanted. That's what it got, and anything more than a signal is--. It could have changed a number of people's attitudes temporarily, but as I say the market is looking at a lot of other broader problems. A half point as against one point is not so important as the fact that the half point was done.

MR. WALLICH. Is it possible at the present time to put a ranking on the various factors that the market weighs in looking at the exchange rate? In other words, in the current account there's improvement; inflation, no improvement; interest rates, a deterioration. What weights should one assign to these?

MR. PARDEE. Well, I just had a lecture from a chartist so I'm not sure what weights to apply myself these days. I think basically we come back to the fact that [market participants] are looking for fundamental improvement. This is what the market is looking for. This is what the corporate treasurers are waiting for. At this stage they are very pessimistic that there will be fundamental improvement. So in the meantime we end up with this--

MR. WALLICH. Would an improvement in the current account, which seems very likely, make up for failure to improve on inflation?

MR. PARDEE. With some it would help. It will change the balance in the market.

MR. HOLMES. Henry, I'd say that clearly inflation would be number one on their minds. If we had some good price statistics, that

would help a great deal. Second, I think is merchandise trade; third, current account; and fourth, interest rates.

MR. TIMLEN. But don't those weights change? Those are the weights today, but the--

MR. HOLMES. Sure they do. But right now I think those would be the important things in that order, roughly.

CHAIRMAN VOLCKER. We have to ratify the transactions, if you are willing to ratify the transactions. Without objection, they are ratified. Maybe we can take up this Mexican swap issue. Scott has distributed a memorandum. We had some material last month and there was a preliminary discussion. Is there anything you want to say, Scott?

MR. PARDEE. Well, simply that it's the Manager's job to make a recommendation and I personally favor this. But [let me cite] the kinds of arguments that the Mexicans raise.

CHAIRMAN VOLCKER. Let me supplement that a bit.

So I would be favorably inclined but I want to hear what other people have to say. Phil.

MR. COLDWELL. Mr. Chairman, I've done quite a bit of thinking about this since we had a discussion on this the last time. At that time I took a position that it was a costless operation in the sense of just raising the swap line, but since then I've had some second thoughts. Yes, it's costless in the sense that we could raise the level of the swap, but it's not costless in a precedential sense.

CHAIRMAN VOLCKER. I agree with that wholly in substance and

I think it's as simple as that. So while I agree with you fully in substance--and as I say I think they would, too, as a theoretical matter--in practice I do not feel that we can press them because I think their argument on the other side is

rather impregnable.

increase of \$360 million, you said? This is an

MR. PARDEE. From \$360 million to \$700 million.

CHAIRMAN VOLCKER. So it's an increase of \$340 million; [I wondered] whether a more modest increase might do the job.

I came to the personal conclusion that fiddling around on the amount--cutting it in half or something and ending up with \$850 million or whatever--just didn't amount to enough to quibble about. I think you have a very strong substantive point, but it just runs against the practicalities

MR. BAUGHMAN. If approved, when it is announced would we announce that it was in response to a request from the Bank of Mexico?

CHAIRMAN VOLCKER. Well, I think these things are probably routinely announced deadpan--by saying there's an increase period.

MR. TRUMAN. Mr. Chairman, that's what we had thought. Something would go into the Policy Record. In the past, there has usually been a sentence of explanation. I would think, without having heard the Committee's discussion, that it would say something about at the request of the Bank of Mexico and in light of expanding financial relations--that side of it.

CHAIRMAN VOLCKER. I have worried about the precedent [issue] that Phil raised, too. I think that is a negative; it is a question of weighing that. Scott may want to speak to this, but we have the precedent of a swap with Mexico; and Mexico is a big trading partner right next door. I think it is adequately distinguishable from any other Latin American [country].

MR. PARTEE. We have a \$2 billion [swap line] with Canada.

MR. EASTBURN. I share Phil's concern about the precedent I am somewhat concerned, however, about what would happen--the matter having come this far--if we were not to approve it. Would there be adverse [consequences]?

CHAIRMAN VOLCKER.

Scott, do you want to respond to both the precedent point and this one?

MR. PARDEE. No, [what you said] is fine.

MR. MAYO. I'd like to move approval, Mr. Chairman.

CHAIRMAN VOLCKER. Do we have a second? I'm just going forward here with an orderly procedure. Henry.

MR. WALLICH. I would like to associate myself with the precedent concern. The State Department has always thought that the Federal Reserve might be a source of credit in one situation or another. They have a low level project going to that effect on how we could lend to LDCs. And it will not be completely easy next time, [when] relations with a large LDC need improving, to say we don't want to participate. It may be that the discussion with Mexico has gone too far and we would do more damage by saying no. But we should be aware that the government--not this particular Administration--in the past repeatedly has pointed to the Federal Reserve as a source of credit in an emergency situation. When the State Department makes a list, the Federal Reserve is normally featured in there.

MR. EASTBURN. Paul, could I ask one more question? Are there any implications if we were to have a less than unanimous vote on this? Is this made public, Murray?

MR. ALTMANN. Yes. It's a change in the Authorization for Foreign Currency Operations.

MR. EASTBURN. Votes are made public?

MR. ALTMANN. It can be held until the Policy Record [is released], which will be three days after the next meeting.

MR. EASTBURN. But the votes are made public?

MR. ALTMANN. Yes, it's a change in the foreign currency authorization.

MR. MAYO. But it wouldn't just say that the Committee approved this. It would say [the vote was] 9 to 3, or whatever it might be.

MR. ALTMANN. Well, we have never done it that way. We've always listed the votes by name.

CHAIRMAN VOLCKER. On every one?

MR. ALTMANN. On every change in the [authorizations and directives].

MR. COLDWELL. Paul, could I ask one more question? I'm a little bothered, Scott, about the last sentence in your memo. That sentence indicates that the State Department and Treasury officials involved in the discussions expressed the view that while they would not urge the Federal Reserve to agree to the increase for the sake of furthering such action by the System, on balance it would be helpful. Does that capture the flavor of your discussions--that they really don't see this as something that is of any urgency?

MR. PARDEE. Paul was the one who held the discussions. I was interpreting his--

CHAIRMAN VOLCKER. I held the discussions.

MR. COLDWELL. But there's no urgency?

CHAIRMAN VOLCKER. Well, on balance, yes, they'd like us to do it. I think that's clear. They have these other negotiations going forward and they think this would be constructive. That is clearly [their view]. How important it is in connection with those other issues is another question, which I can't really evaluate.

MR. COLDWELL. Would we gain or lose anything of substance by having the Treasury provide a statement of support?

CHAIRMAN VOLCKER. I would think our problem is the reverse. I'm just speaking personally. There's no question that they like the idea, but I don't want to get either State or Treasury too involved in saying anything about it for the very reasons that Henry and to some extent you were suggesting.

MR. COLDWELL. Yes, that's why I asked do we gain or lose.

MR. MAYO. It seems to me, Paul, that this last sentence is a delightful art form that preserves our independence, while achieving an objective.

CHAIRMAN VOLCKER. That's precisely what we're trying to do here.

MR. TRUMAN. Mr. Chairman, just to clarify one point. Under normal procedures we would make an announcement of the increase right away, or within a couple of days, once it is worked out with the Mexicans. That announcement would say nothing about the vote. The vote would come out in the Policy Record, which would be published in mid-September. I might say that's right before the [two] Presidents meet. The vote would come out then.

MR. WINN. Mr. Chairman, I wonder if the attitude of the group would differ if the economic outlook for Mexico worsened rather than brightened--if the oil reserves proved to be a little less than now [thought].

CHAIRMAN VOLCKER. I think we have to look at that because I do believe it gives them a leg up. All I can say is that I have looked at that and I think this is manageable in that context. That isn't to say that I cannot imagine a situation where Mexico would draw part of the line sometime but I don't think there's any immediate prospect of that.

MR. WALLICH. If I may, I would say that if Mexico got into trouble, we should be ready to help them and for a larger amount than this swap. I say that not only for the reasons that have always existed but because banks are now more deeply involved. But I would prefer to see that done on its merits rather than on a previous decision to improve relations.

CHAIRMAN VOLCKER. You say on its merits. Speaking for myself, that is in my mind. I came to the conclusion that you've come to and I think that is not irrelevant in considering this. If we never had any intention or would basically be unsympathetic toward Mexico ever using the line, I think it would be a mistake to approve this. But if we do contemplate that in an uncertain world it's not impossible that we would accede to their use of the line sometime in the future, we can go ahead and do it.

MR. COLDWELL. If this discussion got out, I suspect we'd get applications from such countries as

MR. PARDEE. May I speak to this question of precedent? We've had discussions with these other central banks over the years and told them "no," and we can tell them no again. Mexico is a different country from these others. We do have criteria in the files from 1967 and we published in the Federal Reserve Bulletin at that time the criteria for swap partners. Now, we're a long way from 1967, but those criteria have protected us a lot from the possibility--in cases where discussions were getting started on a very informal basis --that the discussions would get much further. But I think we're protected on the economics as well as the convertibility of currency [and] our relations with the central banks. We have a very good relationship with the central bank in Mexico. At some of the other central banks we don't know who the Governor is from one month to the next. So we can protect ourselves, and we have. And I feel I'm one of the first lines of defense on this.

CHAIRMAN VOLCKER. Not many of those Latin American countries have a convertible currency.

MR. PARDEE. That's right.

CHAIRMAN VOLCKER. Well, are we ready to vote? I take it we have to have a full-scale vote, Mr. Secretary?

MR. ALTMANN. Well, it requires a vote. It isn't necessarily a roll call vote, but if there are any dissents we would record that.

MR. BALLE. Might I ask, Mr. Chairman, given the pros and cons of all of this and what we've heard: Would you care to tell us what your recommendation is on balance?

CHAIRMAN VOLCKER. Well, my recommendation is to do it.

MR. BALLE. All right. Thank you.

MR. COLDWELL. Well, [because] of the publicity, I think it would be preferable not to have a split vote on this, so I would vote for it, too.

MR. WALLICH. So would I.

CHAIRMAN VOLCKER. Do you want to call the roll on this?

MR. ALTMANN.

Chairman Volcker	Yes
President Balles	Yes
President Black	Yes
Governor Coldwell	Yes
President Kimbrel	Yes
President Mayo	Yes
Governor Partee	Yes
Governor Rice	Yes
Governor Schultz	Yes
Governor Teeters	Yes
Governor Wallich	Yes
First Vice President Timlen	Yes

Unanimous.

CHAIRMAN VOLCKER. Mr. Sternlight.

MR. STERNLIGHT. Thank you, Mr. Chairman. I would just like to say first that I appreciate very much the Committee's earlier action and expression of confidence. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Questions?

MR. COLDWELL. Peter, what is the dealers' inventory position now?

MR. STERNLIGHT. In issues over one year, as of Friday which is my last figure, they had about a \$460 million net long position. No doubt it is lower now because we did some sizable buying of coupon issues yesterday. We bought almost a billion dollars of coupon issues yesterday, some of which would have come from the dealers' inventories and some from customers. I would guess that they are probably at close to an even position in over 1-year issues.

MR. COLDWELL. I didn't mean a particular date, Peter; I meant a time frame of, say, over the last 3 or 4 weeks. Have they been holding about a plus or an even position?

MR. STERNLIGHT. Well, that goes up and down as the market gears up for a Treasury refunding and then takes on those securities. Typically [dealers] have wanted to be moderately short in their positions because they had that kind of view of the market. They had gotten into a deeper short position as this Treasury quarterly refunding approached. They used the refunding to build up a long position and by now they have distributed securities that they had taken on and have gotten back to close to an even position again, I would say.

MR. COLDWELL. You see no discernable change in their attitude toward keeping either a balanced or a short position?

MR. STERNLIGHT. They seem to want to be in about a balanced or slight short position.

CHAIRMAN VOLCKER. If there is no other comment, we have to ratify [the domestic transactions].

MR. WALLICH. Going back to this earlier statement that the average age of our portfolio is now 4.3 years.

MR. STERNLIGHT. I didn't give that precise a figure.

CHAIRMAN VOLCKER. It was 4 to 6 years.

MR. WALLICH. That 4 to 6 years came in the examination report. That is well in excess of the average age of the total public debt, isn't it? So, we are a substantial factor in helping the Treasury to lengthen the debt unless what they report is only the publicly held debt.

MR. STERNLIGHT. They report it both ways. They give the average length including Fed holdings and government accounts and excluding them. They have achieved a significant lengthening on either basis. I wouldn't say that our behavior has been a major factor in enabling them to lengthen the average.

MR. HOLMES. I think they normally use the publicly held debt as an estimate.

CHAIRMAN VOLCKER. I may not remember [correctly], but I thought that publicly held debt was getting up in the 4-year area.

MR. STERNLIGHT. It might be up to around 4 years or so. I think our average length might be slightly longer. We have been conscious of that and for that reason on the recent quarterly rollovers we have steered a somewhat greater proportion of our rollovers into the shorter options.

MR. WALLICH. Thank you.

CHAIRMAN VOLCKER. [We need to] ratify the transactions. Without objection. Mr. Zeisel.

MR. ZEISEL. Thank you, Mr. Chairman. [Statement--see Appendix.]

CHAIRMAN VOLCKER. I don't know whether you made explicit your assumptions. [You have assumed] no changes in fiscal policy?

MR. ZEISEL. No change in fiscal policy other than the automatic adjustments.

CHAIRMAN VOLCKER. Right. [And you've assumed] the present targets on monetary policy.

MR. ZEISEL. And the present targets on monetary policy.

CHAIRMAN VOLCKER. I would appreciate it if you would confine yourselves at this point to questions and be as brief as possible. We will come back and have comments on the economic situation. John Balles.

MR. BALLE. I really wanted to follow up on the question you just raised, Mr. Chairman. Jerry, have you had a chance to do any calculating on what the automatic changes in fiscal policy might produce--that is, the revenue losses built into your economic model and the expenditure [increases]. I think it's important to all of us. I am certainly struggling to get a fix on how much fiscal stimulus we might get to cushion the downturn, in order to pinpoint the appropriate role for monetary policy in this period.

MR. ZEISEL. Right. [Given] the contraction that we've projected--which affects unemployment benefits most importantly in an automatic way but social security benefits to some minor degree and food stamps and so on--the total impact is about \$1-3/4 billion automatically on transfer payments. The receipts are adjusted down by about \$3 billion, I think, but I don't have those figures [in front of me]. I will have to check that.

MR. MAYO. Is that for calendar 1980 or what, Jerry?

MR. ZEISEL. That is for fiscal year 1980.

MR. MAYO. It would be much more than that I would think in its economic effect, because your figures would reflect the collections on corporate taxes and they would still be running pretty high.

MR. ZEISEL. Yes, that's right.

MR. MAYO. If corporate profits fall off next year, then we are going to have a much bigger effect than \$3 billion, I would think, by fiscal 1981.

MR. PARTEE. The projected deficit goes up \$10 billion next year, Jerry, and I don't think it would go up if we didn't have a recession.

MR. AXILROD. President Balles, it's a measure of the fiscal policy effects that's conventionally [used]. People look at the high employment surplus to standardize for the level of activity. And on that projection--granted the measurement differences among people--the change from, say, the 2nd quarter of '79 to the 4th quarter of '80 throughout is fairly consistently in a restrictive direction. That is, the high employment surplus grows so that more is being taken out of the economy as it gets weaker rather than vice versa. That's just one measure people take as an indicator of fiscal policy.

CHAIRMAN VOLCKER. Governor Coldwell.

MR. COLDWELL. Jerry, could we probe just a minute? In your comment on the unemployment rate, I heard you say that you are forecasting a loss of jobs in the industrial sector. What do you have in the way of advance indicators of employment changes so you could say to us, for example, that the demographics are there to provide X amount of new labor force? [Are there other indicators such as] the loss of help wanted ads in the newspapers, the changes that you see developing in the automobile industry or whatever else to give you some leg up on what the unemployment rate is likely to be over the coming quarter?

MR. ZEISEL. Well, obviously the growth in the labor force is a significant element in our projection procedure. We don't have any concrete evidence from current economic series indicating layoffs of any substantial magnitude beyond the employment figures that I referred to--that is, the cut in manufacturing employment by about 130,000 over the last few months.

MR. COLDWELL. You do have some [accession] rate figures?

MR. ZEISEL. We have those and they don't show any really dramatic changes. Our assumption is that labor force growth will be quite moderate in the coming year--around 1-1/2 percent, which is about half the rate it was in 1978. Characteristically the participation of women has not suffered particularly during recent recessions. That's a function of social and other considerations, as well as the fact that women tend to go into employment sectors which continue growing. But basically we are projecting a fairly stable overall participation rate. That would mean a continued decline in the participation rate of adult males, particularly older adult males and a continued rise, although at a more moderate rate, for women. And I would consider our projections of labor force growth to be on the conservative side. The projections of the employment side, of course, fall out of our production projections.

MR. COLDWELL. On the question of the participation of women, isn't it possible that we may get a more comparable reaction [to that of] men now that the level of participation is [sharply] higher.

MR. ZEISEL. You mean that they would tend to stay or continue--

MR. COLDWELL. Well, that we won't have this division [unintelligible] further increases in participation rates at the time when labor demands weaken.

MR. ZEISEL. Basically, the participation rate of the adult men, let's say those age 25 to 54--what we generally call the core of the adult male labor force--tends to remain pretty stable, and we would expect it to remain stable. There's a certain degree of discouragement reflected in those who are more marginal members of the labor force in that group; they move out [of the labor force statistics] when they're not looking for work. But basically the decline that we get in the [adult male] participation rate when the labor market weakens is among people who are older. They are making decisions about whether to stay in or not. When the employment market is strong and there are attractive job opportunities those older workers tend to stay in. When things look poor and the opportunities are not there, they tend to drop out. So we tend to see some accelerated decline in the participation of men in the age 55 and over group. We would expect that the participation rates would be held up in part by the degree of inflation--the pressure on household incomes. That tends to result in women particularly looking for jobs or staying in the labor market.

MR. COLDWELL. [You have] looked over this range of information, which you obviously thought greatly about. And yet in each of the last 3 months I think you have expressed some surprise

that the unemployment rate has not started to move up. Do you now view that as an immediate possibility?

MR. ZEISEL. I certainly hope so, in a sense. My social conscience is at war with my economic view of [the situation]. The lack of a rise in unemployment, which is the other side of the coin of a cut in employment, is reflected in the enormous deterioration of productivity in the last couple of quarters. Obviously, if one believes the output figures, then employers have not rationalized their labor forces yet; they have not adjusted. Possibly this reflects the fact that they were taken by surprise by the decline in output. Possibly they want to hold off for a while. In any event, I would think that rational behavior would dictate substantial cuts in employment over the next couple of quarters.

MR. COLDWELL. Unless [employers] thought they were going to need that labor in the near term.

MR. ZEISEL. That's correct. But when they look at their books and see what happened to profits in Q1 and Q2--and probably will happen to profits in Q3--given the employment levels that currently exist in the face of declining output, I think those [numbers] are going to be persuasive arguments to them to cut back on employment.

MS. TEETERS. But this is not an unusual pattern at this stage of the cycle.

MR. ZEISEL. It's a bit worse than average but you are quite right, Governor Teeters, that the pattern is not unusual.

MR. MORRIS. It seems to me that it's quite similar to the first half of '74; we had a [comparable] phenomenon at about the same time [of the cycle].

MR. ZEISEL. That's correct. This one seems to be a little worse; the decline in productivity is a bit more dramatic.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. Looking at your projections, am I right in thinking that net exports and the change in business inventories are the two really dynamic factors and that they roughly offset each other with a swing of about \$30 billion at a maximum? My question is about the degree of confidence with which you hold these [projected] sizable swings.

MR. ZEISEL. I think you are quite right, in the sense that they not only offset one another in some respect but also that the degree of confidence we hold in our forecasts [of those two measures] is very similar. However, that degree of confidence is extremely low.

MR. WALLICH. With some of these elements, [such as] consumption, I think you probably have a very narrow confidence interval.

MR. ZEISEL. I'll speak first about inventories and I will let Mr. Truman attack the problems of projecting net exports. Quite frankly, our projections of inventories are determined largely by

business behavior in regard to their management of stocks in recent years. Businessmen have tended to be quite conservative; they have tended to respond very quickly to their perception of any backup in stocks. We saw a number of very small, very rapid adjustments in production, too, whenever there was an indication of stock building. We are projecting a continuation of that behavior. There are indications that inventories had built up in June and in automobiles undoubtedly in July also. There has been some buildup in inventories in real terms elsewhere. We think production adjustments are occurring rather rapidly, but they are not very large so they can be put out of the way rather quickly. And we would expect that businessmen will attempt to continue to keep their stocks more or less in line with sales--in fact on the conservative side over the projection period. But we have a number of equations to forecast, and I don't put any more credence in those equations than I do in this kind of visceral judgment based upon recent past performance.

MR. TRUMAN. We would like to believe that the net export projection is slightly more firmly held than the inventory projection. The facts may not be so right. It is true in the net exports area that we are now dealing with a \$600 billion total--and it's made up of factors which move in very different directions and have different futures--so that the range of error on the net export projection can be quite large if we look out as long as six quarters. I'm pretty comfortable, though, with this projection as it now stands. The oil situation is rather straightforward, based on the assumptions that we have. And the question might be how responsive imports will be to slow growth in the United States. We have put in a fairly modest downturn in real imports in connection with this; it could in fact be larger. On the export side, things look fairly good--carrying through to the middle of next year--as long as growth is reasonable, given the recent growth in major industrial countries. The question I think [arises] in the latter part of 1980, when we do expect a considerable slowdown; if that is more [severe], then clearly exports will fall off less. In terms of the global numbers, the one area of particular uncertainty has to do with service income, which gets fed into these projections. There has been a dramatic increase in service income in the last quarter of last year and the first quarter of this year. We basically have not extrapolated that increase but we have a further modest buildup from the current level. Now, we have been fooled by statistical flukes in those series, so the numbers could be off, but in the basic merchandise trade area, I'm pretty comfortable [with our projection]. I would say that the swing in nominal terms that we have here is much less than that in so-called real terms. It's an area of strength but not a great deal of strength.

CHAIRMAN VOLCKER. I have three names on my list. I hope the questions will be brief and that there won't be any more than three names. I might just say--I can't restrain myself from saying--that these two uncertainties may be mutually related if merchandise trade does so well because the economy is in a recession that is generated by the inventory reduction. If you don't get the inventory reduction you won't have such a good trade balance and vice versa. Frank Morris.

MR. MORRIS. Do you have any estimates of the burden of consumer debt service--taking into account mortgage debt plus other debt--now and how it would compare to 1974?

CHAIRMAN VOLCKER. I refer you to an exhaustive article in the Quarterly Review of the Federal Reserve Bank of New York.

MR. ZEISEL. The level is fairly high and the burden is a bit higher than it was back then. [Mike], do you have those figures?

MR. PRELL. The repayment to income ratio is 23 percent roughly--at the record level.

MR. ZEISEL. That's a record level.

MS. TEETERS. But the peak was reached last fall. It has been drifting down ever so slightly.

MR. PRELL. Consumer installment credit particularly has leveled off but I think the mortgage debt is still drifting up.

MR. ZEISEL. The article in the New York Federal Reserve [publication] makes a point that the simple view of this probably overstates the burden of debt.

MR. PARTEE. Demographics.

CHAIRMAN VOLCKER. It argues that there are many more families now in heavy debt bearing categories, and if you adjust for that and adjust for the credit card debt--which would be a different kind of debt--the figures don't look as high as they do absolutely.

MR. MORRIS. The issue is whether the debt burden seems significant [enough] or not to affect consumer behavior and perhaps create a slower response on the part of the consumer in the upturn than we have been accustomed to in the past.

CHAIRMAN VOLCKER. The conclusion of that article is that [the debt burden] is high but not so high as it looks on the surface. It therefore moderates the conclusion; they still may be [unintelligible]. Chuck Partee.

MR. PARTEE. I just wanted to ask for your interpretation of the retail sales figures, Jerry. [The article] in the paper was a little confusing. The July increase looked very small to me but then there was some talk of a revision in May and June and I couldn't really make it out.

MR. ZEISEL. Yes, that's correct. The July increase was quite small--0.4 both for total sales and sales ex-autos. Both May and June were revised up, which suggests that the second quarter consumption figures will not be as weak as we had thought earlier.

MR. PARTEE. But were they revised very much? This is just a question of fact.

MR. ZEISEL. Other things equal, they probably would revise GNP up by 1 percent or so.

MR. PARTEE. One percent?

MR. ZEISEL. It's fairly significant. But as I pointed out, the pattern is still a relatively weak one.

MR. BALLEES. Just another question quickly, Mr. Chairman, on the fiscal policy matter. Jerry, earlier this year you may remember we called attention to some startling differences between your projections of the high employment surplus and those of the Council of Economic Advisers. They were much different magnitudes and even different signs. Could you bring us up-to-date in a nutshell on where that stands today if you know?

MR. ZEISEL. Well, we still have differences in the level, and those differences are a reflection of a different approach in calculating the figures. We tend to move generally in harmony, however, with the Council's movements at this point.

MR. MORRIS. They both show a rising surplus?

MR. ZEISEL. We both show a rising surplus, yes. I think that's really the most significant way of assessing these numbers. To come back to this issue of how much of a loss as a result of the recession, the projected decline in the deficit increases in our projection between '79 and '80 by about \$10 billion and the high employment move is an additional \$17 or \$18 billion. I guess a very simplistic view would be to add those and it comes close to \$30 billion in fiscal loss. But we will calculate that carefully for you and send a note along.

CHAIRMAN VOLCKER. Mr. Axilrod. You want to give us a survey of what are called financial relationships.

MR. AXILROD. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Thank you, Steve. I am conscious that without an egg timer time has been passing. But I thought it might be useful if I just set out a few thoughts of my own at this point before we have a coffee break. I don't intend to make it a habit particularly, but this is a meeting that is perhaps of more than usual symbolic importance if nothing else. And sometimes symbols are important. I thought I'd just lay out a strategy as I see it so you can have something to shoot at. Take it in the nature of my thinking out loud. I don't know to what extent it will reflect the general feeling of the Committee.

In general, I don't think I have to go into all the dilemmas and difficulties we face for economic policy. It looks as though we're in a recession; I suppose we have to consider that the recession could be worse than the staff's projections suggest at this time. Once the inventories begin going, we don't know quite where they will end up. In looking at the situation that we're in, among other things I don't think we can forget that energy is a sizable factor and that it's not very susceptible to monetary policy. Nonetheless, we do have risks on the down side. When we look at the other side, I don't have to talk much about the inflation numbers; again, energy is a big factor but it's not the only one. And when I look ahead, nobody is very optimistic about the inflation picture. One can add up--and we've been doing it for a long while--considerations that could point to some decline in the rate of increase [in inflation], most of which

have been disappointing as we've moved along. I don't see any very convincing reason to expect much of a decline to come about naturally, so to speak, in the short run, partly because I don't think we're through that energy price adjustment. So we've got to keep anticipating some impact of energy prices on the total.

When I look at the past year or two I am impressed myself by an intangible: the degree to which inflationary psychology has really changed. It's not that we didn't have it before, but I think people are acting on that expectation [of continued high inflation] much more firmly than they used to. That's important to us because it does produce, potentially and actually, paradoxical reactions to policy. Put those two things together and I think we are in something of a box--a box that says that the ordinary response one expects to easing actions may not work, although there would be differences of judgment on that. They won't work if they're interpreted as inflationary; and much of the stimulus will come out in prices rather than activity.

On the other hand, a tightening action obviously has risks, too, when we're facing the kind of business outlook we have. But to some degree the perversity of reactions can help us there. I think there is some evidence, for instance--if a tightening action is interpreted as a responsible action and if one thinks long-term interest rates are important--that long-term rates tend to move favorably. The dollar externally obviously adds to the dilemma and makes it kind of a "trilemma". Nobody knows what is going to happen to the dollar but I do think it's fair to say that the psychology is extremely tender. And as Mr. Pardee was suggesting earlier, we have all sorts of projections of great current account improvement; unfortunately, even those optimistic projections don't really show up in the figures until next year. And with the normal lag of figures, even if the projections are right some time in the next year, I think it leaves us in an exposed or vulnerable position for a period of months, maybe through the end of the year or longer. In saying that I'm not terrified over the idea of some decline in the average weighted exchange rate of the dollar or some similar measure. The danger is, however, that once the market begins moving, it tends to move in a cumulative way and feeds back on psychology and we will get a kind of cascading decline, which I don't think is helpful. In fact, it's decidedly unhelpful to both our inflation prospects and business prospects.

Finally, I would note that the aggregates are running high; Steve just went over that. We're lucky they're not so bad over a long time perspective, but basically the recent figures don't look so good. And of course we've got this underlying question of what these traditional definitions of the aggregates mean anyway.

In terms of our own policy and our approach, I do have the feeling--I don't know whether other people share it or not--that economic policy in general has a kind of crisis of credibility, and we're not entirely exempt from that. There is a similar question or a feeling of uncertainty about our own credentials. So when I think of strategy, I do believe that we have to give some attention to whether we have the capability, within the narrow limits perhaps in which we can operate, of turning expectations and sentiment. I am thinking particularly on the inflationary side. [Can we] restore the feeling that inflation will decline over a period of time and that that's a

prime objective of ours? I think that is particularly critical now domestically in terms of the discussion of a wage pattern guideline that's going on currently and the tenderness of the foreign exchange markets.

Specifically, that suggests that we may have to be particularly sensitive to some of the things that are looked at in the short run, such as the aggregates and the external value of the dollar. When we're sensitive to those things, there's certainly a perceived risk of aggravating the recession. I'm not so sure that we're in the zone where monetary policy itself is all that restrictive in terms of real activity, but there is certainly a perceived risk. Now, I don't know how we get out of that box but it would be very nice if in some sense we could restore our own credentials and [the credibility] of economic policy in general on the inflation issue. To the extent we can achieve that, I do think we will buy some flexibility in the future. If we're going to be in a recession, by all traditional standards the money supply does tend to be a little weak and interest rates go down. I suspect that's a pretty manageable proposition for us if long-term expectations are not upset at the time by any decline in interest rates--an action we might actually have to take to or want to take to support the money supply. But I don't think that approach will be a very happy one unless people are pretty confident about our long-term intentions. That's the credibility problem [and the confidence] we have to establish as I see it. And we haven't got a helluva lot of time as the recession comes along--if indeed it does come along--but particularly if it gets worse.

So, I think we can't ignore the psychological problem that we have at the moment. I don't know what the chances are of changing these perceptions in a limited period of time. But as I look at it, I don't know that we have any alternative other than to try. The other alternative may be letting things go along, and perhaps they will anyway. And if inflation doesn't get better--maybe it will get worse--at some point it will be upsetting enough so that a much more forceful policy, whatever the consequences, will be required. That's not a very happy process. So I think we're in a situation that is not risk free but there are risks on both sides of what we do, and they are pretty balanced.

In saying all that, I don't think that monetary policy is the only instrument we have either. I might say that my own bias is, while I certainly think in the particular situation we find ourselves it's premature to be arguing for a big fiscal policy move, that such a move might be necessary. If it is necessary, it ought to be through the tax side and it ought to be through a tax program that not only deals with the short-run situation but fits into the long-term objectives. I would think the background for that is pretty good in terms of a tax program that might do something for both costs and investment. But I don't think that's anything we are going to get or should promote right in the next month or two. So we don't have a lot of room for maneuver and I don't think we want to use up all our ammunition right now in a really dramatic action; I don't see that the exchange market or anything else really requires that at the moment. Certainly dramatic action would not be understood without more of a crisis atmosphere than there is at the moment. Ordinarily I tend to think that we ought to keep our ammunition reserved as much as possible for more of a crisis situation where we have a rather clear

public backing for whatever drastic action we take. But I'm also fairly persuaded at the moment that some gesture, in a framework in which we don't have a lot of room, might be a very useful prophylactic--if I can put it that way--and would save us a lot of grief later. If we can achieve a little credibility both in the exchange markets and with respect to the aggregates now, we can buy the flexibility later.

So, in a tactical sense, that leads me to the feeling that some small move now--I'm not talking about anything big--together with a relatively restrained aggregate specification might be desirable. I don't intend to define the dimensions of that before I hear your reactions. But that is the framework in which I came into the meeting anyway, and I will be interested in hearing your reactions.

If we talk about almost any movement on the federal funds rate, however small, the discount rate question becomes a relevant consideration. That I do not prejudge in my own mind but if any of the presidents in particular want to comment on that one way or another, I would be delighted to hear those comments, too. I might only say that I'm somewhat allergic to the use of the discount [rate] as pure symbol--in other words move the discount rate and do nothing else because I think there's already some flavor of that in market thinking. We do that about once and that means the symbol is pretty much destroyed for the future. But other than that, I feel fairly neutral about [the discount rate issue] now, before I know how the discussion will come out this morning.

Why don't we have a short coffee break. When we return we'll discuss the economic picture and your general policy bias first, [along the lines of the procedure] Mr. Miller introduced. Then we'll come back [to the policy issue] and get specific about it.

[Coffee break]

CHAIRMAN VOLCKER. I'm not a clockwise, counterclockwise, or protocol man, so if you want to talk at this stage, get on Mr. Zeisel's list--I mean Mr. Altmann's list. I'm sorry, I was looking at the wrong end of the table. I know which way interest rates go even if I don't know which end of the table I'm at! Go ahead, Mark.

MR. WILLES. Thank you, Mr. Chairman. I found your comments very helpful and I am very sympathetic with them. I guess the only thing I'd like to do is to make you feel a little less insecure about the impact of where I think you are heading and what that would imply in terms of the real economy and recession.

It seems to me that as we look at what's happening in the real sector, two issues are relevant. One is what caused the recession that we are heading into. I think you rightly attributed that primarily to the energy problem. And if that's the case--and I happen to think it is--there is really nothing that printing money or, I would add, deficit spending could do to offset that. Second, as you know, we have convinced ourselves at least in Minneapolis that even if that weren't the case, there is no exploitable tradeoff between inflation and unemployment. So [in our view], a conscious decision to go easy on money in order to ameliorate the unemployment effect just really wouldn't have any impact. In fact, that would have the effect

you suggested--that is, it would come out in terms of prices rather than in more rapid real economic growth and less unemployment.

So it seems to me--with inflationary expectations clearly having worsened in contrast to our expectation earlier that they would start to get better about this stage of the year--that we almost single-mindedly have to devote ourselves to the task of doing something about inflation. Then the question is: What do we do and how do we do it? I found Steve's comments very helpful and useful in that they implied a tremendous amount of uncertainty about how to figure out what is happening to the demand for money. I don't pretend to be able to forecast that any better than anybody else, and the implication of that to me is that we have to try rather hard to hold the short-term rate of growth of money in line on the assumption that we can then respond in whatever way is appropriate to hit the long-run targets. I'm impressed by the fact that money is growing too rapidly. We talk a lot about ATS but lots of other [financial instruments] have come into use as money substitutes, as we have talked about; I think you've even mentioned them on occasion, [Mr. Chairman]. If we add any portion of those to the rate of growth of M1, for example, we get really quite large numbers. Let's assume that we get 4.8 percent growth of M1 for August, which I think is the forecast. Any of the ranges proposed in the Bluebook would allow for high double digit growth in September, excluding these other non-M1 factors. I think that would just be much too rapid growth at this very critical time. So I think we need to reduce substantially any of the ranges that are listed here in the Bluebook, perhaps going with the range we have at this time which is 2-1/2 to 6-1/2 percent. And if it turns out that that requires an upward adjustment in the funds rate, it seems to me we've got to do that in the short run in order to head off what I think would be a substantially more serious long-run implication.

CHAIRMAN VOLCKER. Dave Eastburn.

MR. EASTBURN. Paul, I was very much interested in your recital of the almost upside down economy that we are in, where usual roles really have reverse implications. There is one, however, that occurs to me that you didn't mention and that is the possibility that in this kind of world a recession of any magnitude can be inflationary in a longer-run sense. I think that's a real possibility particularly if, as I suspect, the staff's assumptions about fiscal action underestimate the stimulus that we would get if we were to have a recession, particularly one of greater magnitude than now forecast. So I think it's quite possible that we run the danger of overstaying restraint--creating a worse recession than is now projected, stimulating very sharp action on the fiscal front to get the economy moving, having very adverse psychological and expectational effects throughout the economy, and thus in the long run doing more to stimulate inflation than perhaps anything else we could do. All this is by way of saying that my inclination is to be very careful about moving vigorously toward restraint at this time, particularly given the lags that we all know exist between what we do now and the time that it is going to affect the economy.

I'd like to end by asking Steve a question because his answers will determine in part just how confident I feel about all of this. Steve, on your fourth-quarter projections for M1 and M2, you have something like 4 percent and 7-1/2 percent with any of the

alternatives--"A", "B", or "C". Given past history with recessions and what they do to money growth, does that change your confidence level with respect to those fourth-quarter figures?

MR. AXILROD. Given the recession we have projected, which is slightly under 2 percent [negative GNP], and the degree of inflation, I guess I have the normal lack of confidence, but not any more than that. But I would think that [those projections] might be too low rather than too high if the nominal GNP we have forecast develops. I say that because on our quarterly econometric model--and you know there's uncertainty around that--the amount of so-called drift that's implied in that number is 3 percentage points. It's fairly high, and we have turned out to be right in the past on drift. But that we can't be certain about.

MR. EASTBURN. Thank you.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLE. Well, Mr. Chairman, I find myself very sympathetic to the approach that you outlined in your assessment of the immediate and longer-run problems. It might seem odd in a way since last May I was in the distinct minority that thought we ought to ease a bit in view of an impending recession, which our staff had been forecasting for some months. My concern at that time [involved] what was going on in terms of interest rate levels and the effects in financial markets as well as the monetary growth record. There had been a period of very slow monetary growth over a half year. Now to my great surprise we have found just the opposite, with the summer surge in the aggregates. That apparently calmed down in August, but again there's a very strong projection for September, which Steve has already reviewed for us. So it seems to me that we have a credible reason for snuggling up a bit right now and, therefore, I would lean toward what you were proposing, a conservative set of ranges and maybe an Alternative C type of approach for the period immediately ahead. That's simply because the aggregates have shown such strong growth since April--August being about the only exception--and [that surge in growth is] coming at a time when there is great sensitivity about inflation problems and how [that affects] people's behavior and the position of the dollar.

One of the reasons why I was probing on the fiscal policy side this morning was that, while we can't decide this today, in my own mind I have been trying to formulate what could be a longer-run strategy. And it's based on an expectation that is yet to be demonstrated--that we will get a lot of fiscal stimulus, probably coming through a tax cut. That's just a personal guess, obviously. And while we talked about the high employment budget, I'd like to emphasize that in my opinion there is real stimulus in the real world from an enlarging deficit, which we are surely going to get on an NIA basis, perhaps of the magnitude shown in the Greenbook. If we are going to get that kind of stimulus down the road from the fiscal side, whether we want it or not--and I think we are going to get it--it might be a good thing to cushion the effect on the economy. I guess I'm now leaning more toward the view than I was in the spring that monetary policy may have to address itself principally to some gradual deceleration in the inflation rate, because if we don't get that accomplished, we will have an even bigger recession down the road.

CHAIRMAN VOLCKER. Tom Timlen.

MR. TIMLEN. Mr. Chairman, I'm generally in agreement with your comments in the areas of concern that you referred to. Having been trained in the traditions of Benjamin Strong, Allan Sproul, and Paul Volcker, I may have some shadings of view.

MR. PARTEE. Sounds like a tight money man!

MR. TIMLEN. I don't think I will comment in depth on all the areas you touched on, but certainly [foremost] in my mind are the level of inflation, the strong growth in the aggregates, and the tentative position of the dollar in the foreign exchange markets. Sure, we have to be concerned about the prospect of a recession and high [un]employment, but now is a time when psychology is a very important factor. I think the perception of the Federal Reserve's resolve may be at issue and I believe it's timely to give an indication of the direction in which we may be going. It's my judgment that there should be a continuing gradual process of tightening and we should adjust to developments over time as they [occur]. Those are my comments, Mr. Chairman.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. Mr. Chairman, were you not more original and more articulate than I, I would have assumed that you had borrowed my notes to make that talk of yours. I guess the only point on which I might differ with you is that I tend to attribute more of the oncoming recession--if that's in fact where we are headed--to inflation than you did and less to the energy situation. In any event that leads me to the same conclusion: that we ought to approach the recession problem very carefully or otherwise we are going to lay the groundwork for more recession or inflation, and then more severe recessions down the road. And I think we have to deal not only with this recession but with the problem of recurring cycles.

This leads me to the point where I conclude that we really have to do something about the rate of growth in the aggregates. I concur with Mark Willes' remark in that all the ranges [in the Bluebook] seem too high. I'll offer two brief bits of evidence in support of that. If we go back to March, when growth in the aggregates began to spurt, and look at the period from March to September, under alternative B with a money market directive, for example, M1 could grow over that period by as much as 9 percent before we really acted. And that's a pretty long period of time. M2 could grow as high as 12 percent before we acted, and with "C" it's just a tad different from that. The second point is that we ought not to lose sight of the necessity for mentally adding back in 1-1/2 percent to the top of that adjusted 3 to 6 percent range for M1 because it's really comparable to 7-1/2 percent; and we are very near the top of that range now.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. Well, I'm very much aware of the need to balance the considerations of recession and inflation. I think if we tighten up a little now, which is my inclination, we probably will add something to the depth of the recession but not much. And I would not

consider that this may provoke such ill-timed and ill-thought-out responses on the fiscal policy side that we can't do that. I think we have to do what seems right and then contribute as we can in a sensible way to other decisions being taken. Now clearly, monetary policy has eased a great deal in recent months, [looking at] the aggregates themselves or the quasi-monies which we can add to M1, in which case they nearly double the rate of growth. Or we can add them to M4 or M7 and they have a less dramatic impact, but [the quasi-monies] are really pretty close to M1. Real interest rates have become much more negative as inflation has accelerated. And if you can't buy the CPI, you can always take your money abroad and buy a currency that is somewhat like the CPI; people are doing that. So we have had a change in monetary policy that we had not intended. We haven't been going out of bounds [on the long-run ranges] because we had that six months of flat movement in the aggregates from late last year through earlier this year. But I think the important thing is what has happened in recent months.

[Let me mention] one consideration about the real economy. We are projecting, hopefully, a reduction in inflation of 1 or 2 percentage points from a double-digit range in the period after this recession. Remember that in 1974-75 we also got into the double-digit range; inflation was about 12 percent in 1974 and we brought it down to about 6 percent in 1975 and to about 4-1/2 or 5 percent in 1976. In other words we did a great deal better then--at considerable cost in unemployment--than we expect to be doing, at least for the first year of the post-recession period. If that means that we go into a new expansion in 1980 with a base inflation rate of 10 percent or thereabouts and we go through the same experience and the rate of inflation because of an expansion increases by about half of its value, we will find ourselves with inflation in the 15 to 20 percent range. I think that prospect is no longer at all incredible. I don't think our present policies involve very strong inflation fighting; they involve a very heavy component of fighting recession and in my view the result of that will be that we will go through one further round of slightly diminishing inflation and then we will see sharply accelerating inflation again.

CHAIRMAN VOLCKER. Governor Coldwell.

MR. COLDWELL. Mr. Chairman, the situation as I view it has a couple of interesting quirks. As you recall, last fall we talked about the real economy expanding while the monetary economy held quiet. We are now looking at a monetary expansion with a presumption that the real economy is flat. I didn't believe the one last fall, and I don't believe the one now. I think we have either a stock adjustment problem going on or a flow problem. At any rate, I think we are caught in a vicious circle. We start with an inflation rate base of whatever you want to call it--say, 7, 8, 9, or 10 percent. From that comes encouragement for higher oil prices and higher wages; we get lower productivity, we get higher costs, the dollar depreciates, and then we get higher inflation. We have got to break out of this circle, and breaking out of it I think means we have to refuse to validate some of these higher costs and prices. It's going to be an expensive process for us; it's going to be a traumatic process for some of our people. But I think the threat of an intensification of recession, while a cautionary flag, still is not

balanced against the costs of inflation, which are now in the double-digit range and have been there for some time. The costs even if we just take it against GNP are obviously over \$200 billion a year.

We've got to get out of this box. I don't think we are going to break out of it today or tomorrow, but we are going to have to break out of it somehow or we will just continue to have a higher and higher inflation and a constant recurrence of international crises. The downside risks are there, certainly. But there's a certainty to the upside risks, too, in terms of inflation. I haven't had much confidence in these aggregates figures for almost 10 years now. I certainly have not seen anything to improve my confidence in them. The impact on the dollar has come to be a new element in this package and I think in the long run it means that we have to pay attention to our international position, perhaps a little more so than we have done in the past.

All of this says to me that we still have a role to play. Monetary policy can't do it all but its role at the moment is to fight inflation. I would hope that the Committee would also look at the long-range strategy of how we are going to get out of this box that I have tried to portray for you. We need to try to look at the possibilities of getting more certain figures on our money supply, [perhaps by] getting greater reserve coverage throughout the whole range of financial institutions and maybe even some nonfinancial ones also. We must try to get ourselves equipped so we can know precisely what we are creating and be able to limit that creation of credit when we think it is necessary to dampen inflation.

CHAIRMAN VOLCKER. Mr. Kimbrel.

MR. KIMBREL. Mr. Chairman, from my vantage point we are indeed beginning to recognize some slower growth. That may be somewhat less evident in the Southeast than in other parts of the country, but with all of this we are also observing some [developments] that do not provide a great deal of encouragement, specifically in the area of consumer confidence area. Perhaps much of this is generated by the energy concerns and the toll they're taking in every part of the economy and also the contribution they're making to inflation, and that in turn is extracting its pound of consumer confidence. We have never seen the man on the street demonstrating the lack of confidence that he seems to be generating at the moment. Add to this the recent strength in the aggregates and we've become quite concerned about our total credibility. From the foreign exchange side, we seem to be getting unmistakable readings that what we do today and certainly over the next few days will be extraordinarily visible. We will be watched from that vantage point and also [from the perspective of] new leadership on this Committee. I think that makes our action today--and the direction of our action today--more than usually visible. That also spills over into the domestic arena; we are going to be having more than usual concern. I would venture that most of you have been called more frequently in the last ten days than you have before [by people] wondering what was going to happen here today and over the immediately succeeding days.

I recognize the risks that are associated with almost any action we take, particularly if it's in the direction of some slight firming. Even though the movement should be slight--even symbolic,

which is the term I believe you used, Mr. Chairman--I think it would be desirable at this particular juncture. Also I view the [appropriate] timing of the move with some additional pressure in monetary policy [as] now. So if indeed in the not too far distant future we find it appropriate to take a turn toward ease, some strength will have accrued, some different posture would have identified itself with us so as to permit the easing that would be [needed]. But as of this juncture, consumer confidence and attitudes, visibility, [and] both international and domestic [issues] lead me to want to add some degree of additional restraint today.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Mr. Chairman, I have a great deal of sympathy with the identification of the box, which you so aptly described. I personally believe that we haven't started to feel the social costs of inflation and that they are going to surface to an increasing extent this fall, with more attention on them. But in thinking of how we get out of the box that we have sort of built ourselves into, I have less confidence in our forecast of the aggregates than I do in the forecast of the economy--not only in terms of the numbers forecast but what they mean. On the other hand, I think any action we take--because we are certainly in the spotlight today--will be looked at very eagerly and there are psychological reactions coming from what we do. So that would make me just a bit cautious as to how extensive the symbolic action we take today [should be]. Yet in trying to find a way out of this box I think we do have to make some changes. And while this may go against the grain of your background, Mr. Chairman, let me suggest a possible course: I suggest that we shave the ranges of the aggregates and shave them considerably from what appears here. At the same time, we could widen the range of the funds rate and for once in our lives pay some attention to that and let [the funds rate] roam. Doing that gives us somewhat more adaptability to the circumstances as they unfold. It gives us an opportunity to evolve gradually from where we are rather than take an action which, if we get a reaction within the next week, then puts us back in another box that may become difficult. This would avoid tying our hands with respect to future actions, which I am a little concerned we might do with a major action today, although I have sympathy for that sort of move. [Given] my confidence that the aggregates may be much stronger even than the estimates, by narrowing their ranges I think we achieve your goal but do it with a different mechanism than a retention of a policy [unintelligible] at this time.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman I agree on the nature of the box we're in as you described it. It seems to me that we can work our way out of the box if we gear our policy to the aggregates in the next 6 or 8 months. I think we're in a situation very similar to the second quarter of '74 when we had declining final demand. The decline was cushioned by a very large inventory accumulation, financed by a substantial expansion in bank credit, and this in turn I think led to a sharp rise in the aggregates. It seems to me that the problem in '74 was not that we leaned so hard against the expansion in the first half, pushing the funds rate to unprecedentedly high levels, but that we moved so sluggishly when the aggregates failed to grow in the last half of the year. Our slow movement on the other side I think

produced a much bigger recession than was necessary and probably more reaction on the fiscal front than was really productive. So I would agree with your judgment that we should take a symbolic action today that would not be terribly damaging to the future prospects for the economy but would have some symbolic significance to the markets.

I would suggest moving to 11 percent on the funds rate, raising the discount rate to 10-1/2 percent, but giving the Manager a money market directive and informing him that there should be no move beyond 11 percent without further consultation with the Committee. A move of that size is not going to have any major further weakening impact on the economy; it would be slight, but not significant. I think it would yield us some psychological benefits and would be a worthwhile move provided that we're willing to perform differently in the last half of the year than we did in the last half of '74. [We should] really move against a situation in which the aggregates are not growing, and I think that's likely to be the case in the fourth quarter when we get a big decline in inventory accumulation.

CHAIRMAN VOLCKER. Mr. Baughman.

MR. BAUGHMAN. Mr. Chairman, I must join the chorus that has been sung pretty much around the table thus far, although I guess I would have to say I'm not a singer, as John Balles reminded me at the last meeting. Coming from an area where labor markets are [tight] and the turnover of labor is high because of that, [my singing] really doesn't have credibility in these circles. With respect to the box that has been referred to, thus far at least we are calling it a box and not a coffin, which may prove to be overly optimistic.

MR. MORRIS. We could make it into a coffin.

MR. PARTEE. A little latent optimism!

MR. BAUGHMAN. I'm not unaware of the [concern] that is bothering quite a few of us, namely that the historical record seems to say rather unequivocally that we have usually acted late in both up and down periods of the cycle. And insofar as there is an argument in support of a heavier reliance on the monetary aggregates, it is largely because heavier reliance on them would help us to avoid making those errors, if we classify them as errors. But it seems to me if our major problem is inflation, and we visualize ourselves as being in a box and we're trying to find a way out, then we're pretty much forced to orient monetary policy to a rather long-term horizon. Doing that really means we throw in the sponge for our more flexible economic tool, so far as influencing economic activity. And that in turn means that we turn responsibility for the short-term influence of economic activity over to fiscal policy. While I don't like aspects of this, I'm persuaded that that's probably the route we're going to have to go if we want to find ourselves out of the inflation box. Namely, we have to focus monetary policy primarily on getting a [handle] on inflation. That seems to me to force us into a context of working [toward our objective over] a rather long-range horizon and finding some way of defining it. Now a recent Congressional report spells it out in terms of a conventional monetary aggregate. Right at the moment I think it takes a pretty heroic person to commit himself to hitching closely and rather unequivocally--especially over a long time frame--to a monetary aggregate. But I don't really see much

escape from it if we're going to hitch to inflation and that aspect which I think flows from it--I agree with Governor Coldwell--namely, the weakness of the dollar in exchange markets. That's all I have, Mr. Chairman.

CHAIRMAN VOLCKER. Mr. Mayo.

MR. MAYO. Mr. Chairman, I'd like to look at this as an opportunity rather than a box.

CHAIRMAN VOLCKER. Good.

MR. MAYO. Inflation is our number one enemy. This has been declared far and wide, by the President of the United States and the leaders of the Congress as well as by the Federal Reserve. This may not always be the case. There may be some folding on the fiscal side. In fact I would be willing to bet a Suzie to a penny--well, I've got to help publicize [the Susan B. Anthony dollar]--that we will have fiscal stimulus regardless of what we do, as long as we're responsible, of course. If we put the discount rate at 20 percent that's something else. We will be blamed for high interest rates and for causing the recession regardless of whether we move [rates] up a percentage point or down a percentage point at this juncture. We tend to be too thin skinned about that. I don't think we can take it seriously as long as we act within a reasonable margin, which is a much greater margin than this Committee has typically envisioned. We all grant--I think Phil Coldwell put it very politely--that we have a generally shared low level of confidence in the accuracy of our figures on the monetary aggregates. But having agreed with that, I don't know what to do with that fact. I think we have to take the central point of the low level of confidence and work with it partly because--and here we are in a box--we have agreed to and the law has been passed that we are to have targets and those targets have been elaborated on. We obviously have a very concrete belief in some targets that we ratified again just one month ago.

So for foreign reasons, namely the value of the dollar, and for inflation reasons--and not only for substantive reasons but for symbolic reasons--I think this is an opportunity, while everybody is hating inflation so much, to move ahead and to tighten somewhat. I would define "somewhat" as it was just defined--I forget by whom but I think it was Frank--as an 11 percent central rate. A range of 10-1/2 to 11-1/2 percent [for the federal funds rate] is fine with me. Maybe we could [trim] our aggregates [ranges] down a half point but I wouldn't go farther than that because I think we would make trouble for ourselves. But I'd be ready to reverse, again partly for symbolic reasons and partly for substantive reasons, with this rather hazy concept we have of the distribution of the lagged effect.

CHAIRMAN VOLCKER. Mr. Partee.

MR. PARTEE. On balance I guess I agree with Frank Morris more than anyone, although there are points of similarity [with other views]. I think the economic outlook is so bad that I wonder whether I'm missing something. That is, it seems to me that a substantial drop in consumption will have more effect than any other factor on capital spending. A substantial drop in capital spending and consumption will have a major effect on inventories, and the prospects

are that we're in for a very serious recession if this continues. So I've looked around for some things that would tell me I was wrong about that. There are a few. First of all, Frank, the stock market hasn't gone down. I've looked back and in every other recession the stock market has dropped fairly early. In fact, it has gone up over this period. And those are people who are betting their money on the future course of events.

The second thing that's interesting to me is that the risk premiums haven't increased in the securities markets. They are close to their lowest point even for Chrysler, which is probably only the first of a number of corporations that will get to be in serious difficulty. Even Chrysler hasn't [seen a rise in] those risk premiums, looking at low-grade corporates as against high-grade corporates or corporates as against governments or municipal bonds, low and high grade. And even for Cleveland, the low grade muni premium is not large.

The third thing is that the behavior of the money supply is extraordinarily strange. We haven't had a period associated with a recession in which we had really weak money growth followed by quite strong money growth. It has been a rather mixed picture, but generally speaking the monetary aggregates weaken and stay on the weak side; they may be positive but they stay on the weak side until pretty close to the lower turning point. This time we seem to have had 4 to 5 months now of strength. It could be a change in the demand function, as Steve suggests, but that always bothers me because we can just do that. Arithmetically anything we don't understand [is explained as] a change in the demand function. Or it could be an intent to look through the recession. Indeed, all three of these indicators might be a reference to the public's attitudes--an attempt to look through what they perceive to be a modest recession and to build on the future. If that's the case, we might not have much recession.

So, I'm pretty much forced back to the aggregates as the only decent guide we have. And as long as they're rather strong, I'm not terribly uncomfortable about our contribution, plus or minus, to what's happening to the system. They're a little too strong, I think, because they are running up through their ranges pretty fast. And as Bob Black and I guess Mark Willes pointed out, they could very well get to the top of the range or go above it in another couple of months if we happen to have strong numbers. I know all the problems with the aggregates, but I don't think they're as bad as most of you do. And I think we ought to be guided by the aggregates, recognize that they are high in the range and take a little defensive action on account of that. I also think the market so anticipates some little firming as a result of today's meeting that not to do it would have its own impact on psychology and attitudes. So I would be prepared to see a little tightening partly because I'm not sure what these strengths in financial markets mean and partly because we're running high on the aggregate ranges and we have just again reported to the Congress on them and our intention to stay within them.

For the funds rate I would suggest maybe a range of $10\frac{3}{4}$ to $11\frac{1}{4}$ or $10\frac{1}{2}$ to $11\frac{1}{4}$, with a midpoint of $10\frac{7}{8}$ percent. I think we ought to reduce the short-term aggregates ranges a little but it's a mistake to reduce them too much because we will just look silly

since we don't have any effect on them--to speak of--with our policies in the next month or two. I'd maybe take a point off the aggregates of alternative B, both the lower and upper ends and go with a money market directive. That is what I would propose today.

CHAIRMAN VOLCKER. Mr. Rice.

MR. RICE. Mr. Chairman, I listened with interest to your comments at the beginning of the discussion, and I appreciate a good deal what you had to say. I agree [with what you said on] economic policy, increasing prices, and credibility. I also agree that if there were some action or set of actions that we could prescribe that would strike a really significant blow against inflation, turn around public expectations of continued inflation, and restore the confidence that you mentioned, that would be an imperative thing to do. However, I'm conscious of the need to balance the goal of moving against inflation as well as doing what we can to minimize the impact of recession. Obviously the economy today is weakening; even you recognized yourself, Mr. Chairman, that the recession may turn out to be worse than the staff now projects. Clearly most of the economic indicators are weakening; very few show any strength at all. My own feeling is that the recession is likely to be deeper than we now are willing to recognize. It may be true that increasing the money supply right now would result in higher prices instead of stimulating real growth, as Mr. Willes pointed out. But it may also well be true that any restrictive action that we're likely to take, given the causes of the current inflation, would be unlikely to have much effect except perhaps symbolically. I doubt myself if any action we take will have any really significant effect in restraining the current inflation.

So I would be most reluctant at this time to move in the direction of further restriction. I can't help noting that money and credit are already tight and interest rates are very close to their historic highs at the present time. To move further in that direction, in the face of the obvious evidence of a weakening economy, seems to me to run the excessive risk of making the recession deeper than it might otherwise be. I might be persuaded differently over the next few days or weeks as additional data come in, but at the present time I would prefer to see us follow a steady course--that is, not move in the direction of further restrictiveness. But also because up to the present time the unemployment figures have not risen significantly, I would be opposed to taking any easing actions. I would therefore want to follow a policy of steady as we go. I'd stay with the policy that we had adopted previously. I think this would translate, so far as the monetary [aggregates] are concerned into alternative B, keeping the ranges roughly where they were.

CHAIRMAN VOLCKER. That's not, of course, keeping the ranges where they are.

MR. RICE. No, I realize that.

CHAIRMAN VOLCKER. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. I, like everybody else around the table who has [spoken] this morning, am mindful of the balance needed between the [potential] depth of the recession and the need to fight inflation. Over recent months, my attention has been more focused on trying to moderate the depth and the length of any

recession that seemed to be clearly on its way or perhaps already in progress. I guess that's a very comfortable position when the aggregates are indeed growing at a moderate rate or even at a very low rate; we can [then] afford that luxury. But things have changed. The projections we're looking at now of as much as six months of very high rates of growth in the money supply ultimately will translate in my judgment into a worsening of the inflationary outlook.

I would come to the position then of suggesting that we have to move against those growth rates in the money supply. The question is how and by how much. I would note that this Committee has taken interest rates, as measured by the federal funds for example, a full half percentage point higher since the last meeting on July 11. That's not an insignificant move. The proposal around the table is that we take another 1/2 point [increase] immediately; that's a full percentage point from one meeting to the next. There's been a change in the Chairman of this Committee; there have been changes in several other aspects of the Committee itself. That [increase in rates] may have a public perception that would be acceptable in the short run. On the other hand, it seems to me that in view of the past movement we've already had--and if there is indeed a lag in how interest rates affect the growth rate in money supply--then I would oppose going up at this time in any major step.

I would like to propose that if the markets question where we are [on the funds rate]--whether it's 10-5/8 or 10-3/4 percent--we indeed validate a move to 10-3/4 percent. And I'd set the ranges in such a way that they would be below either "A", "B", or "C" as they appear in the Bluebook. I would have them be 1 percent off the "B" ranges of 4 to 8 and 7 to 11 percent, with a rather restrictive federal funds range of 10-1/2 to 11 percent. And if indeed we get the growth projected by Steve and his staff for the latter part of August and into September--particularly those first 2 weeks in September which apparently is a crucial period--we should be prepared to move to 11 percent and let the Desk work within those ranges, but [I'd go] no further than 11 percent.

You asked, Mr. Chairman, for some comments with regard to the discount rate. If we were to move [the funds rate] to anything above 10-3/4 percent--if that's the decision of this Committee--then it would be my feeling that the discount rate probably should go up and by as much as 1/2 percentage point. I would prefer, on the other hand, if we do stay fairly stable--that is, at the 10-1/2 percent target we have now--that the discount rate remain where it is. Only if we move to 11 percent should consideration be given to a discount rate move.

CHAIRMAN VOLCKER. Mrs. Teeters.

MS. TEETERS. I'm glad to find we're all in agreement that we don't know what's going on or what to do about it. I can live with a minor tightening at the present time, given a 10-1/2 to 11 percent range on the federal funds rate and some reduction, possibly, in the ranges for M1 and M2. However, I would like to join Frank Morris in that I think we're not going to be there very long. We should be fully prepared between the next month or two to start moving back from these ranges as the recession develops. I think we are going to be facing an underlying real economy that will probably turn out to be

somewhat worse than is being projected at the present time. If that's true, we're going to see jumps in the unemployment rate in the neighborhood of 1/2 percent a month and I think it would be the right policy when the unemployment rate starts to rise to show some response to the developing recession, partly because it's a proper policy stance for monetary policy to take and partly to reduce the size of the fiscal stimulus, which will be on everybody's mind when we get those types of increases in the unemployment rate.

I don't want to do very much now. I don't think it's going to have any impact on the inflation rate. I can't really believe it's going to do a great deal in the international market because what went on in the international area was not connected to underlying economic events but was basically a reaction to political events. However, a minor tightening at this time--I'm saying 10-1/4 to 11 percent on the funds range--I would find acceptable. And I'd urge the Committee to be constantly watching the developments in the economy for the turning point at which we can back off. There will not come a time in the next six months at a very minimum in which we can say we have won the fight against inflation and therefore we can lower the rates. I'm sure that will be an argument down the line--that we still have a raging inflation and therefore we should not react to domestic developments. So I would go along with the recommendation in alternative B, with some adjustment in the ranges.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. Yes, sir. I purposely waited until the end of the batting order because up until the last few expressions of opinion I was so wholeheartedly in agreement with everything that was said that I didn't want to express that agreement until everyone was committed verbally to that position. I didn't want to drive others off!

I subscribe, Mr. Chairman, to your introductory remarks. I think they express the best analysis of a longer-range strategy that I've heard since I've been a member of this group. You have publicly expressed your determination to do whatever possible with monetary policy over a long range. Certainly we aren't going to bring inflation down in a 6-month period. And certainly we're never going to bring inflation down if we act on a month-to-month, quarter-to-quarter [basis of] fine-tuning. I think it's terribly important, as so many others here have said, that we do something symbolically today to reinforce the credibility of the policies that you have expressed in the short time you've been Chairman.

Specifically, I would favor at least the alternative C program. I think we have to move toward widening the fed funds range and freeing interest rates to move more freely. I would perhaps go beyond that, as Mark Willes expressed, by reducing the monetary aggregate ranges even below those in alternative C. But I would not recommend anything more of [unintelligible] than that shown under alternative C.

CHAIRMAN VOLCKER. You made one mistake at least, Mr. Roos. Vice Chairman Schultz has not yet spoken.

MR. ROOS. I eliminate my remark from the record!

CHAIRMAN VOLCKER. He carefully husbanded his [remarks at his] first meeting. He participated at the very beginning and this won't be the very end, Fred, unless you're so dramatically persuasive that we immediately--

MR. SCHULTZ. Well, I want you to know that I shall protect my position as the caboose with fervor! My feelings are pretty much the same as I expressed to you yesterday, Mr. Chairman. It seems to me that inflation and credit demands, the difficulty in projecting the aggregates, and the sensitivity of the dollar would argue very clearly against any easing. On the other hand, in spite of the little snapback that we've had in July, the economy is certainly very fragile. And in spite of the persuasive arguments in the Federal Reserve Bank of New York [article] on demographics and credit cards, I continue to be worried about the level of consumer debt. I'm very concerned about consumer confidence, not just because of the Michigan and Conference Board surveys, but in light of the longer-term kinds of studies that are made about consumer confidence. I just don't know how low that can go and I don't know how serious the recession could get. I think that is a clear and present danger, so I would argue against any very strong moves to tighten.

That leaves me to suggest that we stay where we are or tighten moderately. It seems to me that at this point in time a message is very important, so I'm persuaded that we should tighten moderately. I am concerned that the messages we send be clear, which under ordinary circumstances might make me want to take a little stronger move than I would support today. But in the present circumstances, with everything that has been said in the media and with the changes in leadership, it seems to me that any move toward tightening is going to be a fairly clear message. I would hope that sometime in the future we could narrow the aggregates ranges and let the fed funds be perhaps more volatile. But I would be a little concerned about that right now, as perhaps muddying the waters a little on the clarity of the message. I would also have a bit of concern right now about raising the discount rate because I would like to save some powder if the message is not taken as we think it is going to be. So I would come down generally in favor of alternative C; but the fed funds rate range I would prefer is Governor Partee's 10-1/2 to 11-1/4 percent.

CHAIRMAN VOLCKER. In view of the hour and the fact that a number of people were very specific in their comments, I wonder whether it's not appropriate for me to try to put something quite specific on the table and let you shoot at it.

First, let me make a couple of comments that occurred to me in listening to you--some points of agreement and maybe disagreement in some cases. We work with these aggregate ranges; we now have two [sets] of them [depending on] whether we modify them for ATS and NOWs or not. When I look at the modified ones in particular, the question that Governor Wallich raised keeps occurring to me--whether we were anticipating all the events that brought about the quasi-monies and near-monies that we got this year. I certainly wasn't. And I think there is a rather persuasive case that money in that statistical sense is much easier than either of the particular statistics we use suggests. There were a lot of comments about our needing to move perhaps against a decline in the aggregates later on; I don't know

what's going to happen there, but I allow for that possibility. I remain very concerned that to the extent possible--and we may have very little time--we do it from a position of strength in terms of our total posture rather than weakness. That move which may become necessary may almost be forced upon us [and] will be taken unnecessarily amiss in terms of our longer-range concerns about inflation.

Inevitably, all this brings up the question of fiscal policy. Let me give you a more hopeful [view] on that. Maybe I haven't been in Washington long enough--on this tour, anyway--but obviously if the recession turns out worse than now projected, let's say, there will be a lot of pressure on fiscal policy. I would say--I'd say it in this room anyway, though I certainly wouldn't say it publicly now--that I'm not sure that's altogether a bad thing, given the way personal income is acting and given the direct drain on purchasing power that comes from the oil situation. I do think there is a considerable risk, which some senators impressed upon me at my hearing, that if the Administration doesn't come up early with a tax program that they would like, they will have forced upon them a tax program of a kind we wouldn't like. [I mean by the latter] the kind of pure "get out the purchasing power as quickly as possible" program. I don't know what others who have been up [on the Hill] think about this; maybe Nancy [has some thoughts on it]. I suspect when it comes right down to it, the Administration may have a fairly clear idea of the kind of tax cut it wants--and there was some Congressional sympathy still--which would be in a constructive long-term direction. I don't know when the proper time is, if ever; I think it depends upon the business situation. But I am not entirely unhopeful that if it comes to having a tax cut, (a) it might be a good thing, and (b) there is a reasonable chance of shaping it in a constructive short- and long-range direction. Now, maybe that's entirely too optimistic but I'm in the business of being optimistic now. Is that blowing smoke completely, Nancy?

MS. TEETERS. I don't think so. There is a tremendous amount of sympathy on the Hill to roll back the payroll taxes. And for the first time there was constituency pressure of an enormous amount on the payroll tax increases last year. I think the people have become terribly sensitized to them with the rapid increases of recent years. My concern is that we may again [find ourselves] in many ways politically in the fall of '74--when the Administration waited until there was a palace revolt in mid-January before even proposing any sort of tax action. It seems to me, as we get further into the fall, that the type of tax cut that the Administration wants and the type of tax cut that they want on the Hill are going to be very close together.

CHAIRMAN VOLCKER. Well, that is my hope too. Nobody can project how it will come out, but I think they are in the same box--to return to that--as we are. But it's premature to begin suggesting that kind of thing now until we're right up against it. It's inherent in the position that we're in.

MR. WALLICH. I have not thought of a payroll tax cut per se as structurally a very desirable device. I would have thought [more favorably] of something that undoes the great increase in the

corporate tax resulting from under depreciation. If all they did was to remove that, by replacement costs depreciation--

MS. TEETERS. I think what they basically have in mind is a payroll tax [cut] because it would reduce pressure on prices and reduce costs directly on the employers' side. There's also a possibility of some adjustment on depreciation--accelerated depreciation or investment tax credit.

MR. MORRIS. Also, if you're going to give something to business, you've got to give something to the consumer.

MS. TEETERS. Yes.

CHAIRMAN VOLCKER. I think you've got to give something to the consumer, so it may be some combination of that sort with some emphasis on the investment side. Now, I've got a personal problem--other people do, too--with the payroll tax pure and simple because of the linkage between the payroll tax and the benefits. So, I don't know. But we're not going to resolve fiscal policy here this morning. I'm just not quite as pessimistic about it as some of your comments [implied].

The other thing that occurred to me--I don't know whether anybody mentioned this or not--is that any of these aggregates ranges shown for the short run in comparison with the short-run ranges we have currently could be interpreted as an easing. I don't know how serious that is. It is true that they are substantially higher than the present ones we're working [toward].

Well, let me try something here and just shoot at it. On the aggregates, I don't think I can't bracket everybody's implicit or explicit comments, but there was a considerable amount of commentary that we ought to go below any of these ranges [shown in the Bluebook alternatives]. The least we can go below them is 4 to 8 percent and 7 to 11 percent. On the federal funds range--I'm speaking personally but I think it may coincide with some other views--I tend to think of it asymmetrically. It depends on whether we think of the range asymmetrically or put the asymmetry right into the specifications. We have another problem just in terms of the message issue. Right now, while the market is a bit confused about the federal funds rate [objective], there is a substantial body of opinion that thinks we're at 10-3/4 percent, and at the least I think we have to confirm that. Frankly, I don't know quite where we are because when I listened to people earlier I was changing my mind. Maybe I ought to change it again. I was [thinking] in the fairly immediate situation--I'm not talking necessarily tomorrow, but this week--of something like 10-7/8 percent or maybe even with a little flexibility, say, around 10-7/8 up to 11 percent. That is consistent, I guess, with a range of 10-3/4 to 11-1/4 percent. Obviously we can widen that out. Or I suppose the alternative is something like the 10-1/2 to 11-1/4 percent that some people mentioned, which also gives us a 10-7/8 midpoint if I did the arithmetic correctly.

MR. PARTEE. Well, that does; but the other range gives you 11 percent.

CHAIRMAN VOLCKER. Yes, and we would treat it asymmetrically low, I think. The asymmetrically low [concept] reflects the fact that we really don't want to have a surprise in the aggregates and move lower too quickly for a couple weeks with some low aggregate figures. My persistent problem with this is that I never know what those aggregates are going to show next month. I hate to be at the whim of a really temporary move in the aggregates, which is why we always have this question of how wide to make the federal funds rate range. But let's say, so I can elicit some responses here, 4 to 8 percent [for M1], 7 to 11 percent [for M2], and 10-1/2 to 11-1/4 percent as one version of the funds range. Or if you want to tighten it up on the low side, 10-3/4 to 11-1/4 percent is basically the same starting point, maybe shaded in the second case to something like 10-7/8 percent or 10-7/8 to 11 percent. Presumably we would go up to the 11-1/4 percent if the aggregates come in strong. And if they come in really strong, we'd have to have a telephone conference. If they come in the other way, presumably we'd have a telephone meeting.

MR. BLACK. A money market directive or an aggregates directive, Mr. Chairman?

MR. PARTEE. I never heard anything that sounds more like a money market directive.

CHAIRMAN VOLCKER. I have no particular feeling about that, one way or the other.

MR. BLACK. Well, the trigger points would be very different, as I view it anyway.

CHAIRMAN VOLCKER. I don't have any strong feeling about a money market or an aggregates directive. I suppose an aggregates directive would make me lean more toward the 10-3/4 to 11-3/4 percent range just in case of a fluke and the aggregates came in too quickly on the down side. Governor Coldwell.

MR. COLDWELL. Mr. Chairman, I did not express myself on the aggregates or the range for the federal funds rate. I thought we were talking principle more than anything else on the first go-around. I would like to view this as kind of a 3-stage process: that we would lead with a small increase in the federal funds rate, move with the discount rate, and then appraise whether the federal funds rate needs to be moved after that. I'd like to see a strong policy statement drafted at the time of the discount rate action. And while you haven't asked for [our comments on] this, I'm going to throw it in anyway: I'd like to see us increase our intervention in the international field, with the idea of strengthening the dollar or giving it some upward push at the moment. I'm afraid we have downward pushes headed at us down the road and if we've got any stability, I'd like to get a little money in the bank to work with.

Now beyond that, on the funds rate and so forth, I'm not a fan of these ranges. Nevertheless, I have to work within what the Committee is paying attention to, so I'm going to specify the ranges I think would be appropriate. Those ranges would be: 4 to 7 percent for M1; 7 to 11 percent for M2; and a funds range of 10-1/2 to 11-1/2 percent, with the understanding that we do not exceed 11-1/4 percent without consultation but move promptly to an 11 percent rate.

CHAIRMAN VOLCKER. John Balles.

MR. BALLES. Mr. Chairman, most of what you are suggesting as a possible position here I find--well, let me say acceptable. I'd like to move a touch more promptly to 11 percent on the funds rate. There's one caution I'd like to draw, and maybe I'll be a voice in the wilderness this month as I was last month. We all agree that the aggregates are getting increasingly harder to understand. In my view that's much more true of M1 than M2. I made the suggestion last month --but got no support, I'll have to say--to put more weight on M2 formally in the directive just for the reason that it is behaving less erratically than M1. I hope before the next meeting of this Committee to share with you an updated paper by my staff on what the recent behavior and experience with M2 has been. It's really quite encouraging in terms of the demand function being pretty stable and coming back on track after departing in the first quarter, despite all the vagaries of Regulation Q and what have you. The only specification that I dwelled on, Mr. Chairman, was your very high range for M2 at 7 to 11 percent. The projections of the staff for the growth of the aggregates in September are very high, bringing M2 especially up near the top of this range. I think that's too high. And if we're going to pay any attention to coordinating our short-term 2-month goals with our longer-term goals, I think we really need to bring the range for M2 down to a point where we won't continue to depart from the midpoint [of our long-run range]. It sounds awfully radical but I'd like to suggest a range [with an upper limit] no higher than 9 percent--perhaps 5 to 9 percent on M2--just so we don't get increasingly off track from the midpoint, which is the provisional target that I personally would like to shoot at.

As far as the fed funds range is concerned, I could go with the range you're talking about as long as we move pretty promptly to 11 percent. If that is done, I think we should follow that up with an increase in the discount rate of a full half point. And I'd feel more comfortable with an aggregates directive to make sure we don't let the aggregates get too near their outer bounds without triggering some action on the federal funds rate.

CHAIRMAN VOLCKER. Frank Morris.

MR. MORRIS. Paul, I would just say this: Since we're after some symbolism here, I think we'd get a lot more symbolic impact at 11 percent than at 10-7/8 percent. I think a movement of [only] an eighth of a point might produce a perverse reaction from the market. It seems to me that a nice round odd number like 11 percent is what we ought to be seeking.

CHAIRMAN VOLCKER. I can understand that argument.

MR. WALLICH. I think we have a choice of either a narrower aggregates range that is likely to be triggered on the up side before we pull it down or being a little more generous on the funds rate. I could go with 4 to 8 percent on M1 and 7 to 11 percent on M2 provided we move to 11 percent on the funds rate and have a 10-1/2 to 11-1/2 percent range, with the possibility of that being used if it is triggered by the aggregates under a regular aggregates directive so that there's a gradual movement. If we don't want to do that, then I would say that we ought to pull down the upper end of the aggregates

ranges and maybe the lower end also in order to have a narrower funds rate but an earlier trigger. I would prefer the first version: 4 to 8 percent, 7 to 11 percent, and [on the funds rate] 10-1/2 to 11-1/2 percent and a move to 11 percent.

CHAIRMAN VOLCKER. Would you go down to 10-1/2 percent if the aggregates were within those ranges?

MR. WALLICH. Well, you have to [accept] the logic of this.

CHAIRMAN VOLCKER. You could always make the ceiling higher. I have no name on my list.

MR. WILLES. Henry made the point that I wanted to make. I would just like to follow up and point out that if we take 4 to 8 percent with a money market directive and if the forecast for August is correct, then M1 growth in September would have to be over 11 percent before we move [on the funds rate]. And that's 11 percent without any add-on for any of these near-money things. Somehow that just doesn't strike me as being a very forceful move to combat inflation. So, I think we really do have to decide either to drop the ranges substantially if we're going to have a money market directive or we almost have to have an aggregates directive so that we begin to move if those numbers come in very high in the range.

MR. AXILROD. Mr. Chairman, there is the possibility that the Committee could adopt a mixed directive--and the Committee once had such a directive--that in effect was aggregates on the up side and money market on the low side. That is, you'd move the funds rate up if the aggregates were high in the range but you wouldn't [lower the rate] until growth is below the bottom of the range. We had wording at one point for such a directive.

CHAIRMAN VOLCKER. Mr. Mayo.

MR. MAYO. Steve's point is one I was going to make. I think we could do that. As far as the figures are concerned, surprisingly, I would support what Henry just said: 10-1/2 to 11-1/2 percent with a central point of 11, and for the aggregates 4 to 8 and 7 to 11.

CHAIRMAN VOLCKER. Mr. Timlen.

MR. TIMLEN. Mr. Chairman, I was prepared to vote for one of your first two alternatives: moving the funds rate up to the area of 11 percent with a funds range of 10-3/4 to 11-1/4 percent, M1 at 4 to 8 percent, and M2 at 7 to 11 percent. I think the important thing is the movement of the federal funds rate. And if the general thinking of the Committee is in terms of an objective of 11 percent, I'd be prepared to vote for [any of several] variations in the M1 and M2 ranges--whether it's 3-1/2 to 7-1/2, 4 to 8, or 4-1/2 to 8-1/2 percent for M1, for example. My leaning would be 4 to 8 on M1 or something shaded down from that, but I think the key in the eyes of the market is where we put the funds rate.

MS. TEETERS. I'd be willing to support the 10-3/4 to 11-1/4 with a funds rate of 11 percent and have your [proposed] ranges of 4 to 8 and 7 to 11 percent. But I would be very much opposed to the mixed directive. It seems to me that we're at a potential turning

point of rather major proportions and if the money supply does come in very low, then [a standard type of directive] would operate to move the rate automatically down.

CHAIRMAN VOLCKER. I'm not sure with those specifications that we need the mixed directive.

MR. PARTEE. I'd prefer that, too, because I think it would look awfully bad to have a biased directive in what may be a developing recession of size. So if we have that very tight constraint on the funds rate, we won't move it obviously without consultation. I might point out that we can move it up if in fact Mark's fears are [realized] and September turns out to have a double-digit growth rate. We can always have a telephone conference.

CHAIRMAN VOLCKER. No other comments?

MR. BLACK. Mr. Chairman, I think I make a lot more of these trigger points than most people do, and Henry's and Mark's points are important to me in selecting the ranges because they do trigger [action on the funds rate] at different points. In one case it triggers when [the aggregates] get near the top or move beyond the top of the ranges and in the other it triggers when they move significantly beyond the midpoints. So with an aggregates directive we would have wider ranges than we would with the money market directive, necessarily just by the sheer arithmetic of it. My preference, which I could alter to some extent, would be an aggregates directive that would trigger at an upward [move at] somewhere around 6-1/2 percent on M1--which would be a range of 3-1/2 to 7-1/2 percent --and at around 9-1/2 percent on M2, which would be a range of 6-1/2 to 10-1/2 percent. I don't know what federal funds rate is consistent with that, because I despair of ever picking out of thin air some range that will give us predictable behavior of the aggregates. But my best guess, which is certainly uninformed as I think everyone else's is, is about 10-1/2 to 11-1/2 percent. And I would favor moving to 11 percent now and once we get there, and get that rate firmly established, following with a half point increase in the discount rate.

MR. GUFFEY. Mr. Chairman, I've been sitting here puzzling over some of the comments with respect to what the speakers perceive to be the need to move to 11 percent to hold the growth of the aggregates in late August and in September to something less than has already been projected. First of all, those are guesses. So it seems to me that we have to focus upon what level of interest rates is appropriate for the economy in the period ahead while still moving against the pressures of inflation. Moving to 11 percent isn't going to lessen the pressures of inflation. With that kind of puzzlement I would say--and I guess I'm repeating myself--that we have taken rather substantial steps in the last month. And since I don't see that at this point an additional 1/2 or 1/4 percentage point [on the funds rate] will bring those growth rates down any in the next six weeks, I would prefer to stay where we are at 10-3/4 percent.

CHAIRMAN VOLCKER. I will stipulate that a 1/4 or 1/8 percentage point move on the federal funds rate isn't going to have any pronounced effect on the growth rates in the next two months--if that's the only thing we're worried about. I'm not sure it's the only

thing we're worried about. [Unless] somebody else wants to say anything, all I can do is try again. I'm not sure, but I think there is a little more sentiment for moving to 11 percent now than I had judged. I'm going to give you two more alternatives. We can stick with the 4 to 8, 7 to 11, and 10-3/4 to 11-1/4 percent with the midpoint [on the funds range] at 11 percent and move there. Or we can go to, say, 3-1/2 to 7-1/2 and 6-1/2 to 10-1/2, which a number of people suggested--and it [moves] some distance toward other [suggestions]--and we can shade the 11 percent a little on the low side. I'd still like the flexibility to play in that area--perhaps go after [something around] 10-7/8 to 11 percent [on the funds rate].

MR. COLDWELL. From my perspective, Mr. Chairman, it's most important that we move to 11 percent promptly. I don't think 10-7/8 does us any good because we're in effect already there. I am bothered by the [monetary growth] ranges having a level as high as 8 percent or even 7-1/2 percent, but I can buy that with a money market directive, which gives us some movement if [the aggregates] come in at the upper end of the ranges. It seems to me, then, that if we want the 10-3/4 to 11-1/4 percent [funds range], that just gives us a 1/4 point to work in, which bothers me a little. But the telephone is always there and we can call a meeting and raise it if we have to.

CHAIRMAN VOLCKER. Well, shall we get a show of hands from voting members on 10-3/4 to 11-1/4 percent and the midpoint where it is, with 4 to 8 percent and 7 to 11 percent [on M1 and M2]?

MR. MAYO. Preference or acceptable?

CHAIRMAN VOLCKER. Well, let me have preferences first.

MR. ALTMANN. What's your midpoint?

CHAIRMAN VOLCKER. 11 percent.

MR. BALLE. Which directive, Mr. Chairman?

CHAIRMAN VOLCKER. Following Phil, here, the money market directive at the moment. With that high a range, I'm a little worried about an aggregates directive. Again, there's just some uncertainty about what will happen in the very short run. I just looked over Tom's shoulder and New York already has a lower estimate for these aggregates; it might be triggered on the low side before we know it.

MR. PARTEE. They did before, too.

CHAIRMAN VOLCKER. Well, I don't attribute any great weight to that other than the inherent uncertainty in these things. I have been watching those numbers enough that my discount factor is extremely high. The trouble is my discount factor on all these numbers is extremely high in any short-run period. Let me just ask the preferences first. Well, let's go all the way and say acceptable.

MR. PARTEE. So, you're asking: Is this acceptable?

MR. BLACK. This is alternative number one?

CHAIRMAN VOLCKER. We'll try out another one, but let's try this one: 4 to 8, 7 to 11, 10-3/4 to 11-1/4 [moving to the midpoint of] 11 and a money market directive.

MR. ALTMANN. 1, 2, 3, 4, 5, 6, 7, 8, not counting yourself.

CHAIRMAN VOLCKER. Well, we can try out another one if somebody tells me what to try. Is it with slightly lower ranges for the aggregates?

MR. WALLICH. I would bring those down a little.

CHAIRMAN VOLCKER. Well, let's try them a half point lower, with the same federal funds and what--change it to an aggregates directive just to get a little variety?

MR. BLACK. Yes, let's do that. I think it makes a whale of a difference.

CHAIRMAN VOLCKER. Who suggested money market? Well, who likes that better? It's 3-1/2 to 7-1/2 and 6-1/2 to 10-1/2, and the same federal funds range but with an aggregates directive.

MR. MAYO. Do you really mean better or just acceptable?

CHAIRMAN VOLCKER. Well, let's say acceptable. That seems to have a smaller vote than the other.

MR. ALTMANN. Four.

CHAIRMAN VOLCKER. I don't know what other combination to try, so I think we'll just go with the first one unless somebody has an inspiration here.

MR. COLDWELL. The only way I can see that you really might separate this as to what we're looking for is 10-7/8 to 11-3/8 percent on the federal funds range with a money market directive.

CHAIRMAN VOLCKER. The overwhelming impression I have is that at this point the changes are not highly significant. Let's vote on the original.

MR. ALTMANN. It's 4 to 8 percent, 7 to 11 percent, a funds rate range of 10-3/4 to 11-1/4 percent with an 11 percent midpoint, and a money market directive.

Chairman Volcker	Yes
President Balles	Yes
President Black	No. I agree with half of

it, but I think the ranges are too high with a money market directive.

MR. ALTMANN.

Governor Coldwell	Yes
President Kimbrel	Yes
President Mayo	Yes
Governor Partee	Yes
Governor Rice	No
Governor Schultz	Yes

Governor Teeters	Yes
Governor Wallich	Yes
First Vice President Timlen	Yes

It's 10 for and 2 against.

CHAIRMAN VOLCKER. Thank you. It's 1:30 p.m. What other business do we have here? Oh, I had one thing I wanted to mention, the [lending of] Treasury [securities], if we can dispose of that in a hurry. I take it there was one question that preoccupied the staff, which is whether we charge when we lend securities. I find it difficult to imagine when [that authority] will be used, so it's not an absolutely central issue to me. I take it that we've always charged, obviously, for the short-term extension of credit. In this case, we're not really extending credit in the same sense. We're lending securities upon which we continue to earn interest. However, in the market would you like to charge or not?

MR. COLDWELL. I'd like to charge because it's a substitution for direct borrowing.

MR. PARTEE. I would like not to charge because we do in fact get the return on the securities. This is a--

SPEAKER(?). But don't we want to urge them not to do this?

CHAIRMAN VOLCKER. If it will speed up things, I thought of a great Solomonic approach on this of charging an eighth, which is less than we charge--

SPEAKER(?). How about 3/16th!

CHAIRMAN VOLCKER. Without objection, we'll charge 1/8 point.

MR. MAYO. I think that's silly. I'd just leave it at zero.

CHAIRMAN VOLCKER. I'm really at the wishes of the Committee on this one. I take it there's a certain amount of prevailing sentiment to charge. Do we want to have a vote on this or just agree? Without objection, it'll be an eighth. Oh, [do we need to talk about] swap renewals, Mr. Pardee?

MR. PARDEE. There's nothing coming up before the next meeting that is of importance, so I would pass on it.

CHAIRMAN VOLCKER. Okay. I had one other item. The House Banking Committee issued a report on monetary policy and there is a paragraph in that report which says: "The law requires the Federal Reserve to report on its monetary targets to 1980. In this the report is disappointing. The Federal Reserve merely indicates that tentative approval has been given to the retention of the present targets through 1980. No justification is offered. This is particularly distressing in view of our committee's recommendations in its report of March 12, 1979 that long-term monetary growth targets should be adopted. Our committee requests the Federal Reserve promptly to correct this defect by issuing a supplement to the report fully explaining its monetary targets for 1980."

I would suggest that I write a letter to the [Banking] Committee saying that perhaps you misread our report. [I must admit] I haven't read it myself! In case you didn't get the message, we did say that the targets at this point were the same for next year as this year, but there is an unusual amount of uncertainty, statistical and otherwise, attached to [that decision]. We did not mean to say that we were not suggesting a target for next year, but obviously we will review it with great care in February. With your permission I will write such a letter.

SEVERAL. Hear, hear.

CHAIRMAN VOLCKER. Thank you. The date of the next meeting is September 18. The meeting is adjourned.

END OF MEETING